2001 Annual Report

PENN NATIONAL GAMING, INC.

THIS BOOK BELONGS TO

Penn National Gaming, Inc.

825 Berkshire Boulevard, Suite 200, Wyomissing, PA 19610

(610) 373-2400 www.pngaming.com

TABLE OF CONTENTS

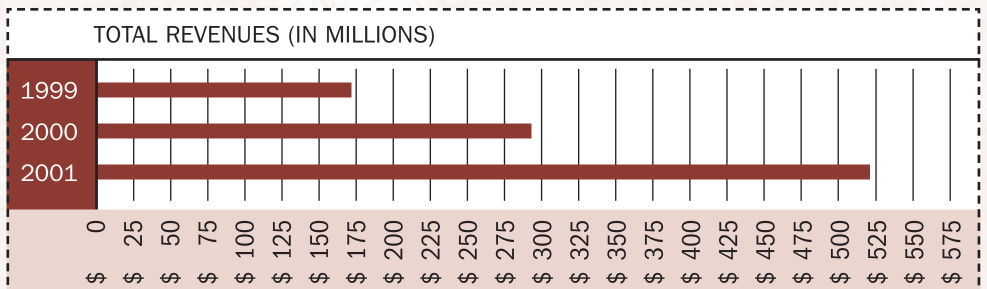
PENN NATIONAL GAMING

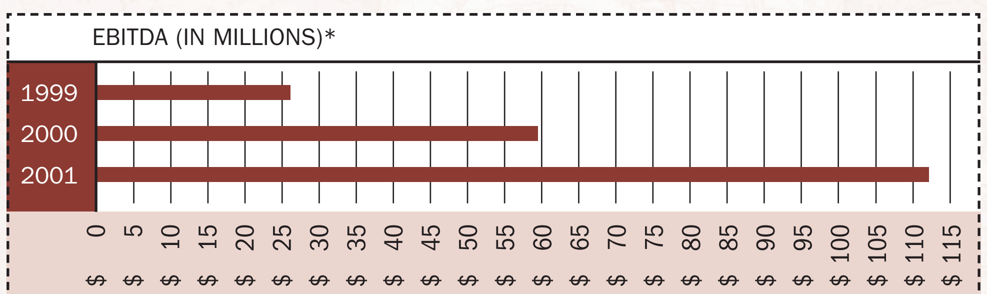
LET'S EMBARK ON AN ADVENTURE . . . and visit each of Penn National Gaming's properties.

PENN NATIONAL GAMING HAS BEEN ON an adventure of its own in recent years – operating in a period of acquisition that has allowed the company to become a leader in the gaming and entertainment industry.

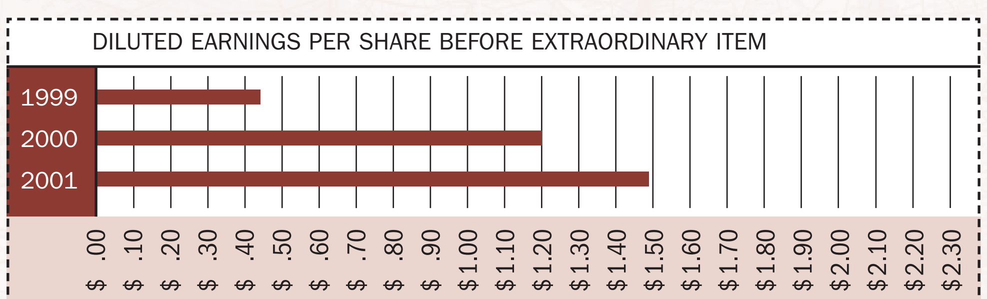
OUR TRAVELS WILL TAKE US TO WEST VIRGINIA, Louisiana, Mississippi, Pennsylvania, New Jersey, Ontario and Colorado. Let's get started!

CONSOLIDATED FINANCIAL HIGHLIGHTS





* *Earnings before interest, taxes, depreciation and amortization (EBITDA)*



YEAR ENDED DECEMBER 31,	1999	2000	2001
(In thousands, except per share data)			
Income statement data			
Total revenues	$170,360	$291,801	$519,392
Income from operations	17,665	45,120	77,712
Income before extraordinary item	6,733	18,575	23,758
Net income	6,733	11,992	23,758
Per share data			
Basic			
Income before extraordinary item	$.45	$1.24	$1.55
Net income	.45	.80	$1.55
Diluted			
Income before extraordinary item	.44	1.20	1.49
Net income	.44	.78	1.49
Weighted shares outstanding			
Basic	14,837	14,968	15,327
Diluted	15,196	15,443	15,918
Balance data sheet			
Cash	$ 9,434	$ 23,287	$ 38,378
Total assets	189,712	439,900	679,377
Total debt	91,213	309,299	458,909
Shareholders' equity	66,272	79,221	103,265
EBITDA	26,496	59,481	112,336

THE YEAR IN REVIEW

DEAR SHAREHOLDERS

We are pleased to report that 2001 was another record year financially for Penn National and that we were successful in our ongoing efforts to further build and diversify our gaming operations. The acquisition early in the second quarter of 2001 of Casino Rouge, a riverboat gaming facility in Baton Rouge, Louisiana, and the management contract for Casino Rama, a large, successful gaming facility located approximately 90 miles north of Toronto, has extended Penn National's transformation into a slot-driven regional gaming company from a 100% pari-mutuel racing operator at the time of our 1994 initial public offering. Our expansion initiatives of the past several years positioned us to overcome national and regional horse racing declines and about 81% of our record 2001 revenues and 85% of our record 2001 EBITDA was derived from gaming operations, with the balance coming from racing.

The second half of 2001 highlighted the strength of our operations and acquisition growth strategy as each of the four gaming properties or contracts acquired since 2000 generated revenues and EBITDA ahead of the 2000 levels. We entered 2002 with solid prospects for further growth from owned and managed assets and continue to seek acquisition opportunities which meet our financial and strategic criteria for growth.

2002 PROPERTY EXPANSION

In the second quarter of 2002, we will complete the Casino Magic Bay St. Louis property expansion which includes a new 300 room hotel adjacent to the casino. In addition to the hotel, this $37 million project includes significant improvements to the casino floor and our entertainment facilities including a variety of restaurants, a spa and 10,000 square feet of conference space - all the amenities necessary to make Casino Magic an outstanding regional overnight destination and one of the most complete resorts in the region.

This May we expect to open a new 1,500 space parking facility at Charles Town which is an important element in this facility's overall expansion plan. We have also commenced construction of nearly 100,000 square feet of new gaming, restaurant, entertainment, and back-of-house facilities at Charles Town that will open in two phases through 2002. Following the parking facility opening in May, the first phase of the casino expansion will open this Summer – along with the placement of an additional 500 slot machines – with the balance of the facility completed by December. Throughout 2003 we have been authorized by the West Virginia Lottery Commission to place an additional 1,000 new gaming machines at Charles Town, so by year-end 2003, we will operate 75% more gaming devices at Charles Town than we do at present. As a result of these expansion plans we expect to see considerable growth at Charles Town in 2002, 2003, and beyond.

FINANCING GROWTH

Early in 2002, Penn National raised approximately $270 million through the issuance of stock and bonds. This new capital was used to repay indebtedness – which was incurred as a result of our expansion – under our existing credit facilities. By reducing debt, we gained the flexibility to finance other expansion opportunities that we may identify that meet our criteria for financial and strategic growth. Importantly, these financings significantly improved Penn National's credit statistics and at present, we have one of the best credit profiles in the gaming industry.

MANAGEMENT

Gaming properties are highly management intensive and require strong leadership to remain competitive with surrounding properties. In 2001 we strengthened our team, both at the corporate and property level with very good results. We expect a few additions to our management in 2002, which should complete our outstanding corporate and property management teams. Penn National now possesses one of the strongest management teams in the gaming industry in terms of the depth of our operational and financial experience.

With our portfolio of diversified gaming assets, expansion plans at key properties, financial flexibility to support further growth and a corporate and property level management team capable of deriving the potential from our growing asset base, we are on track in 2002 to exceed the tremendous results of 2001.

WITH OUR PORTFOLIO OF DIVERSIFIED GAMING ASSETS, EXPANSION PLANS AT KEY PROPERTIES, FINANCIAL FLEXIBILITY TO SUPPORT FURTHER GROWTH AND A CORPORATE AND PROPERTY LEVEL MANAGEMENT TEAM CAPABLE OF DERIVING THE POTENTIAL FROM OUR GROWING ASSET BASE, WE ARE ON TRACK IN 2002 TO EXCEED THE TREMENDOUS RESULTS OF 2001.

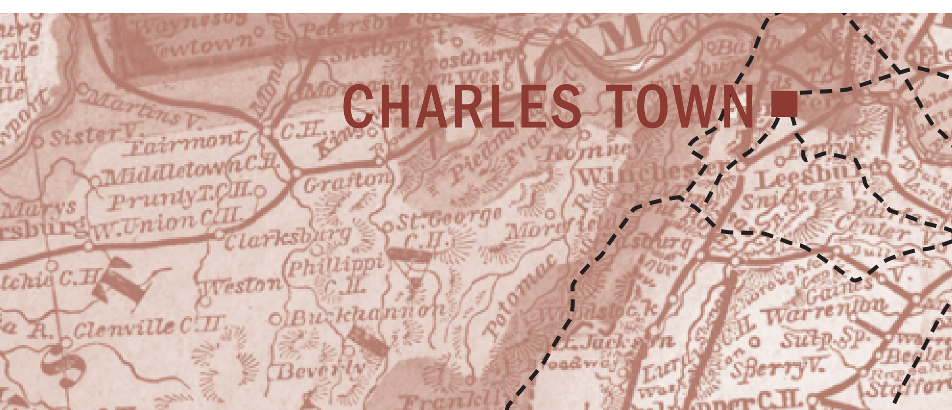
Peter M. Carlino
Chairman of the Board &
Chief Executive Officer

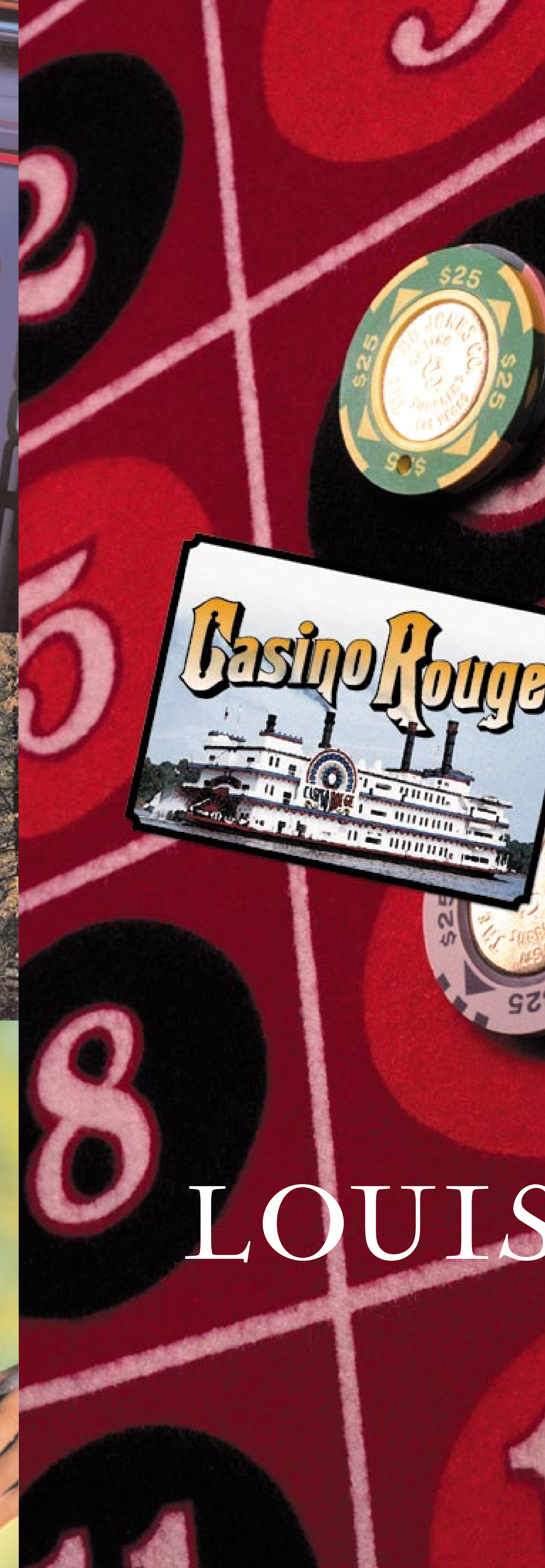
Kevin DeSanctis
President &
Chief Operating Officer

March 31, 2002

WEST VIRGINIA

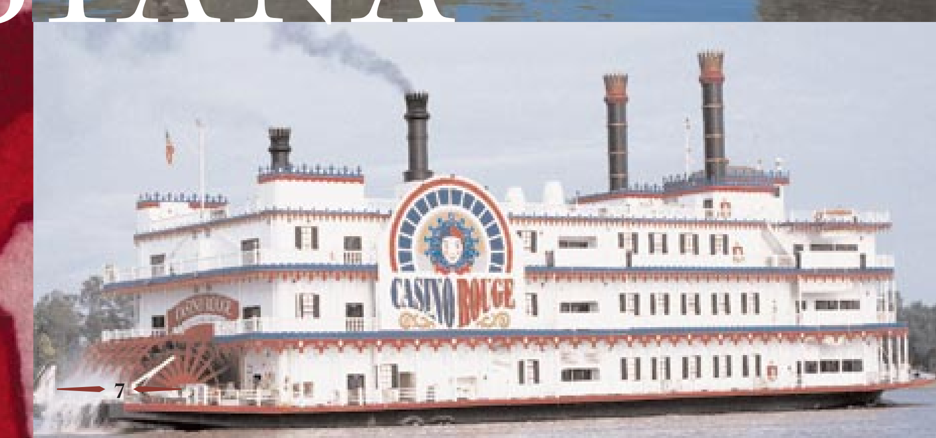
LOCATED IN THE EASTERN PANHANDLE NEAR HISTORIC HARPER'S FERRY, Charles Town Races is nestled in the quaint town of Charles Town, West Virginia. But there's nothing quaint about Charles Town Races – it's a complete entertainment complex that offers both coin-in, coin-out and video slots, live and simulcast horseracing, live entertainment and a variety of dining options.

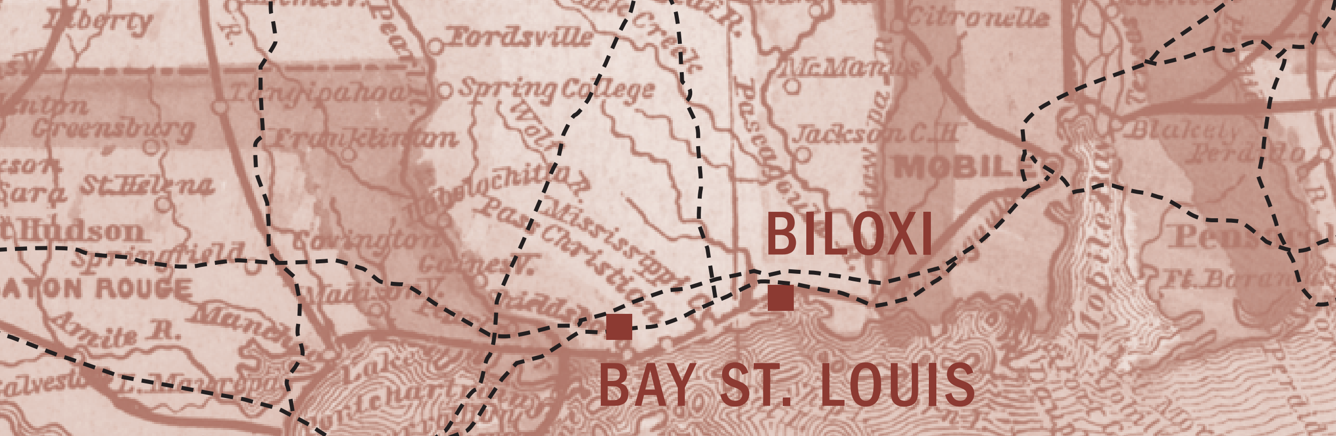




THERE'S MUCH MORE to Baton Rouge than the state capital – it's the home of Casino Rouge, the city's premier gaming hot spot. Nothing is better than being on a riverboat – especially at night. And with over 1,000 slot machines and 38 table games, not to mention live entertainment and a number of dining choices, there's always something to do!

LOUISIANA



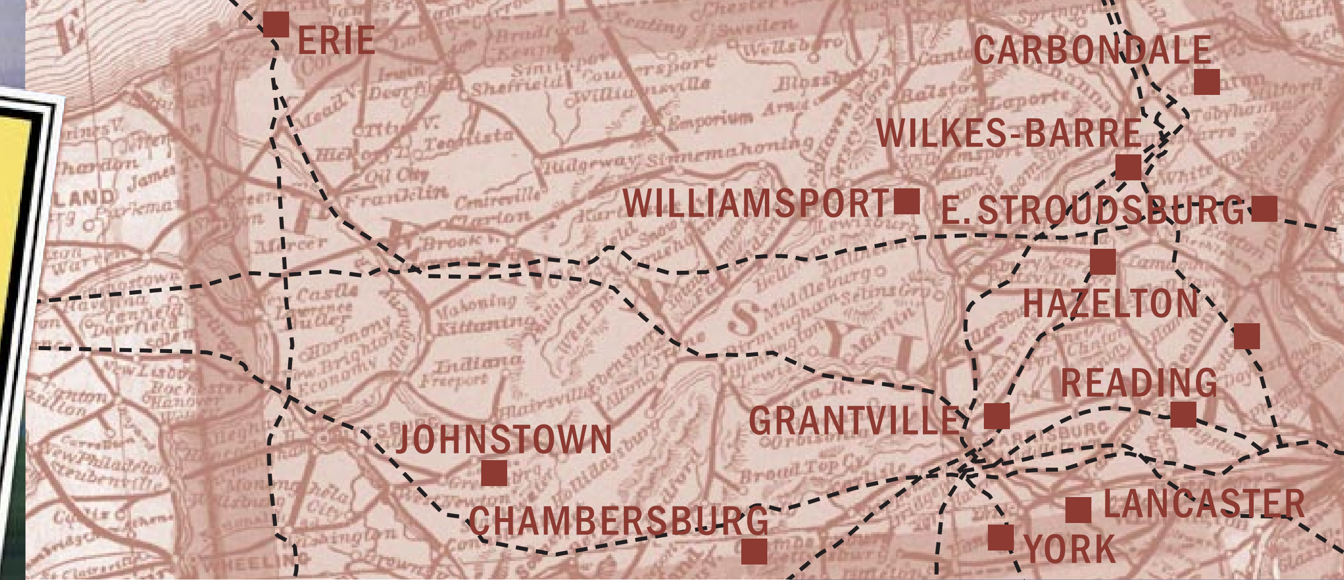


PENN NATIONAL HAS TWICE THE EXCITEMENT in this gulf state!

CASINO MAGIC, IN BAY ST. LOUIS, is the only all-inclusive resort on the Mississippi Gulf Coast. Along with all the slots, table games, entertainment and food you'd expect at a Penn National facility, this property features an 18-hole Arnold Palmer golf course at the Bridges Golf Resort, an RV park with all the amenities and a 200-room hotel. Wait, there's more – opening in May 2002 – a brand new hotel tower with 300 additional guest rooms.

SITUATED ALONG MISSISSIPPI'S HISTORIC back bay in Biloxi, Boomtown Casino boasts a western theme that's a real crowd pleaser. Plus, the Family Fun Center features a motion theater ride and arcade games for the kids.

MISSISSIPPI



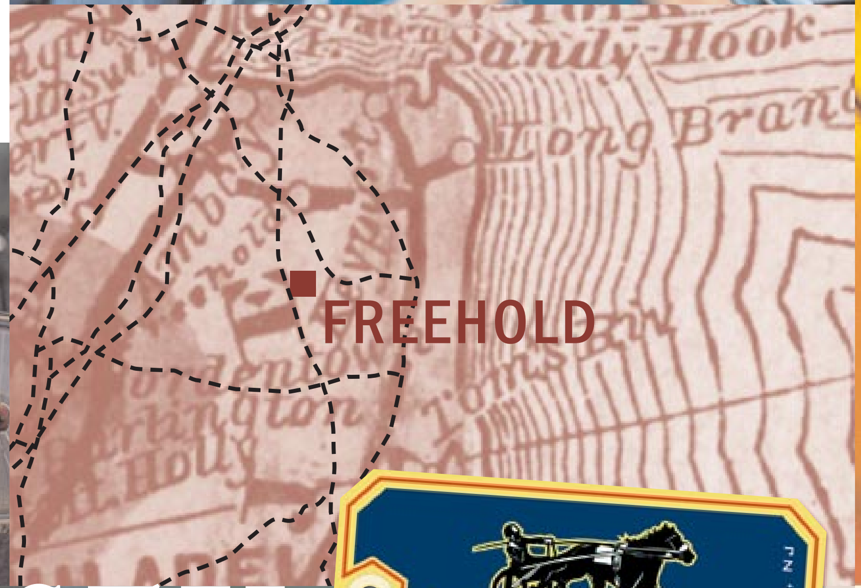
FOR PENN NATIONAL GAMING, PENNSYLVANIA represents the roots of the company. And these roots mean horseracing.

PENN NATIONAL RACE COURSE, A THOROUGHBRED racetrack in Grantville, has been one of the industry leaders for nearly thirty years. Penn National features year-round thoroughbred racing that is simulcast to racetracks around the country.

FANS IN WILKES-BARRE HAVE KNOWN THE EXCITEMENT of live harness racing for over thirty-five years – thanks to The Downs at Pocono. This venerable racetrack features live racing eight months of the year and simulcast racing year-round.

BOTH RACETRACKS OFFER SIMULCAST RACING from thoroughbred and harness venues around the country. The same simulcast offerings can be found at one of the eleven off-track wagering facilities found in Allentown, Carbondale, Chambersburg, East Stroudsburg, Erie, Hazleton, Johnstown, Lancaster, Reading, Williamsport and York.

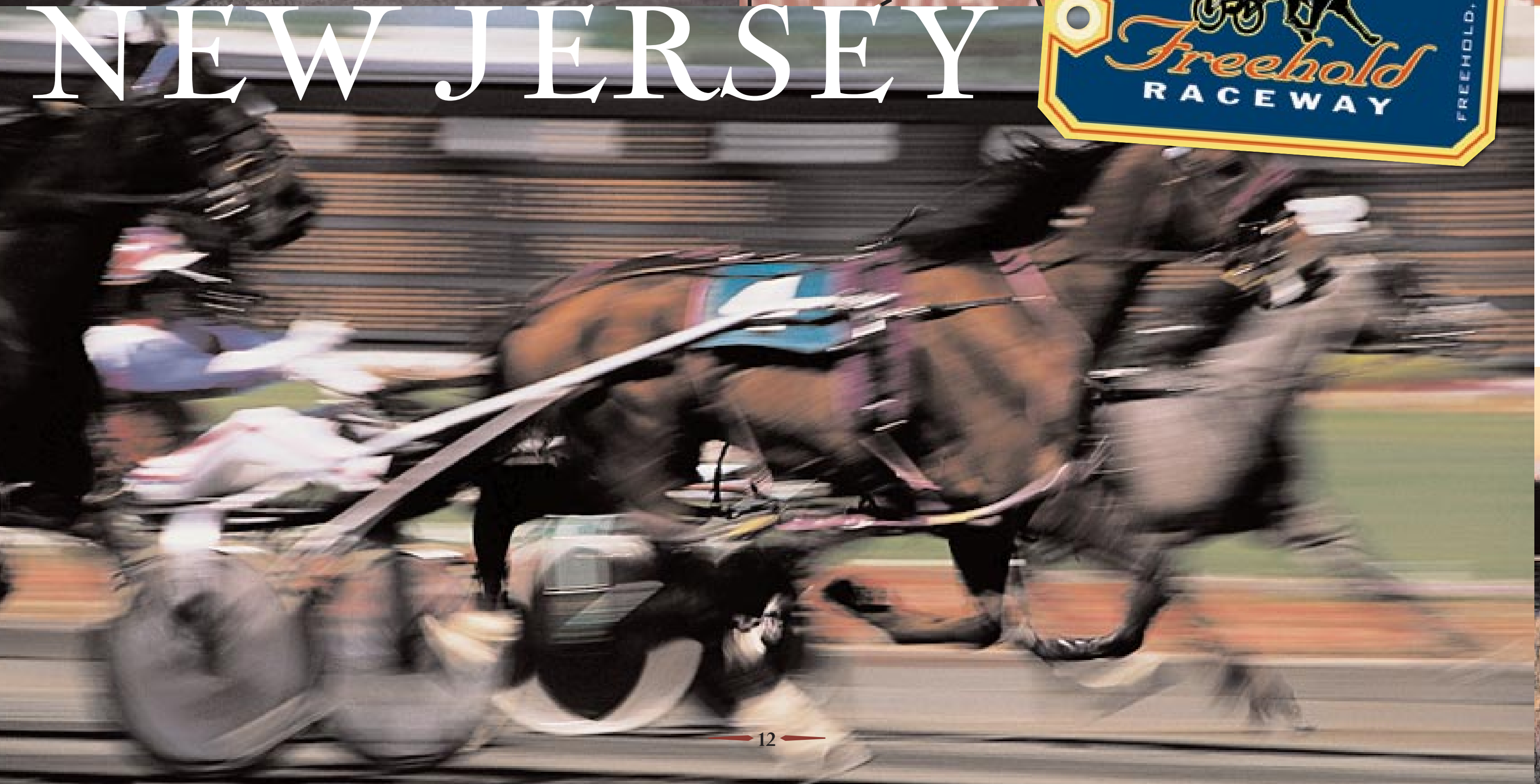
BOASTING THE NATION'S OLDEST AND FASTEST DAYTIME half-mile harness racetrack, Freehold Raceway has achieved legendary status among horseplayers over the years. With live racing ten months of the year, the track also features simulcast racing from domestic tracks seven days a week, 52 weeks a year.



NEW JERSEY

Freehold RACEWAY

FREEHOLD, NJ

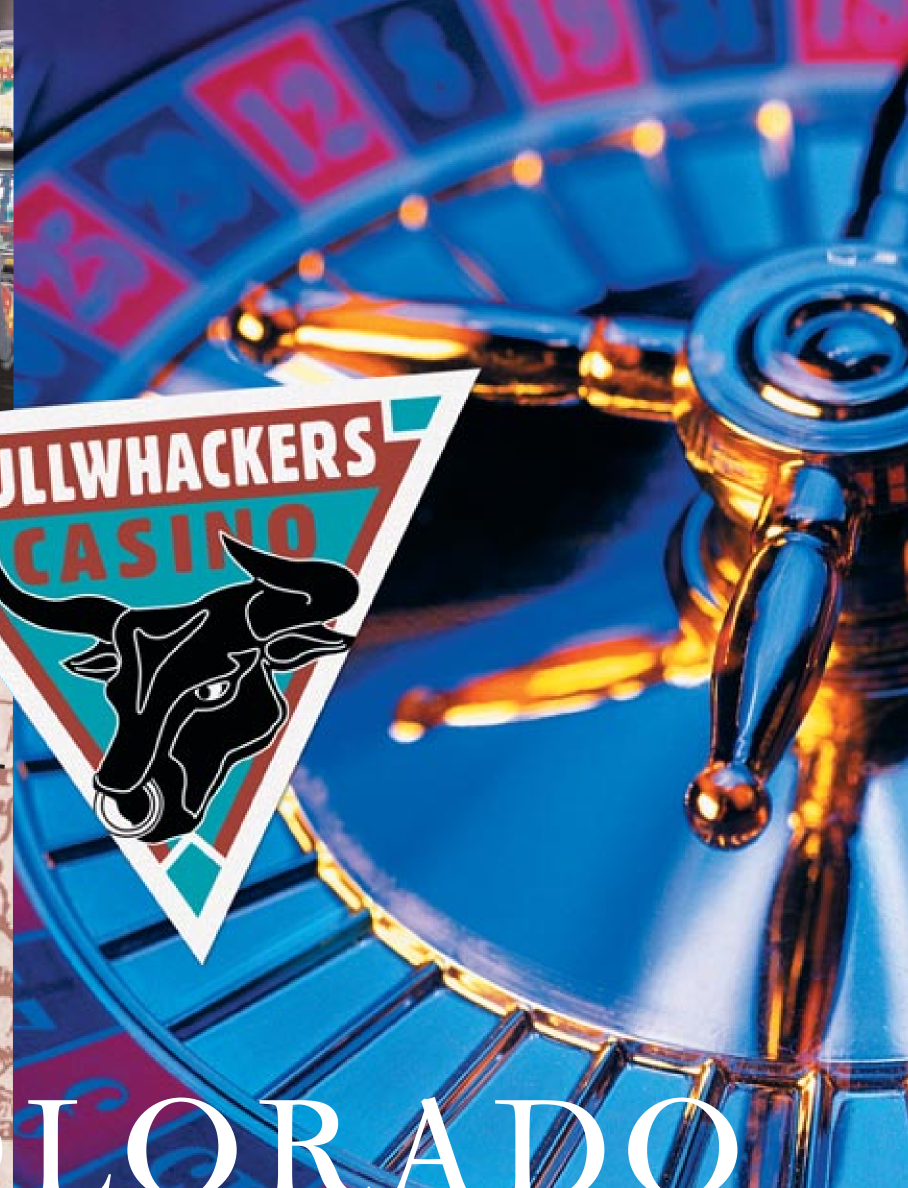


ONTARIO

CASINO RAMA

IN THE LAND OF ICE AND SNOW LIES ANOTHER HOT SPOT that is managed by Penn National Gaming.

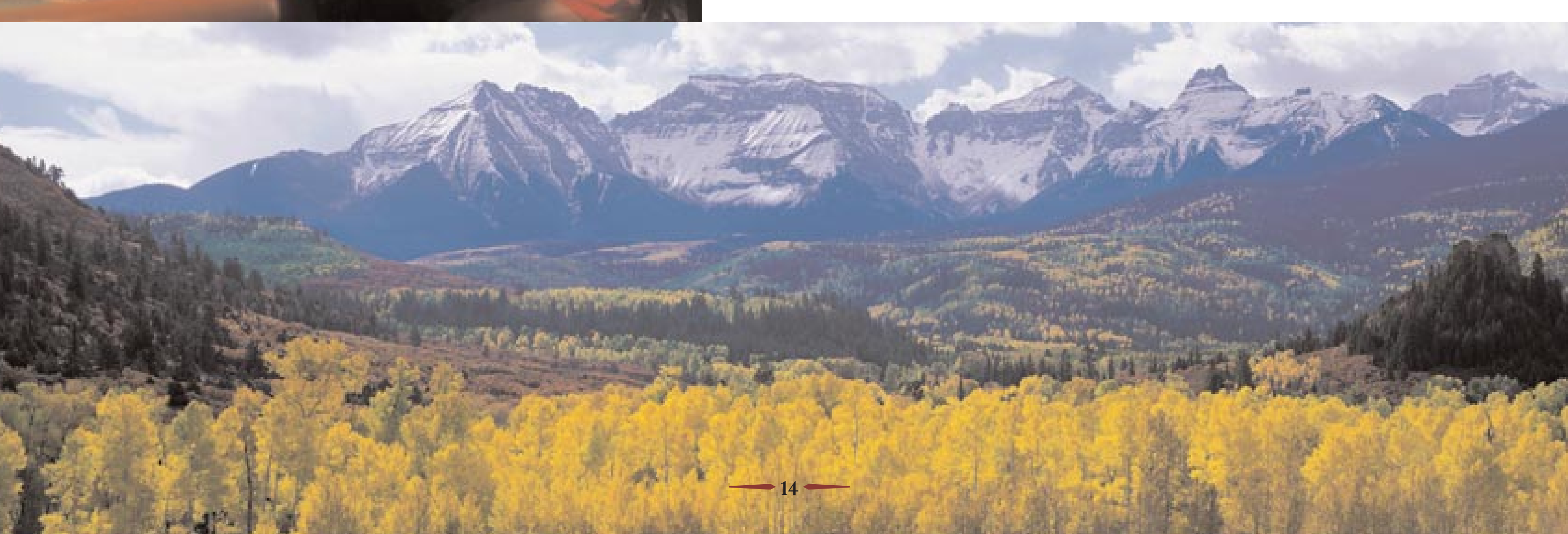
Casino Rama, just north of Toronto, is an entertainment complex beyond compare. With over 2,100 slot machines, 122 gaming tables, seven restaurants *and* a state-of-the-art 5,000 seat Entertainment Centre for concerts, theatrical productions and sporting events, there's never a lack of excitement.

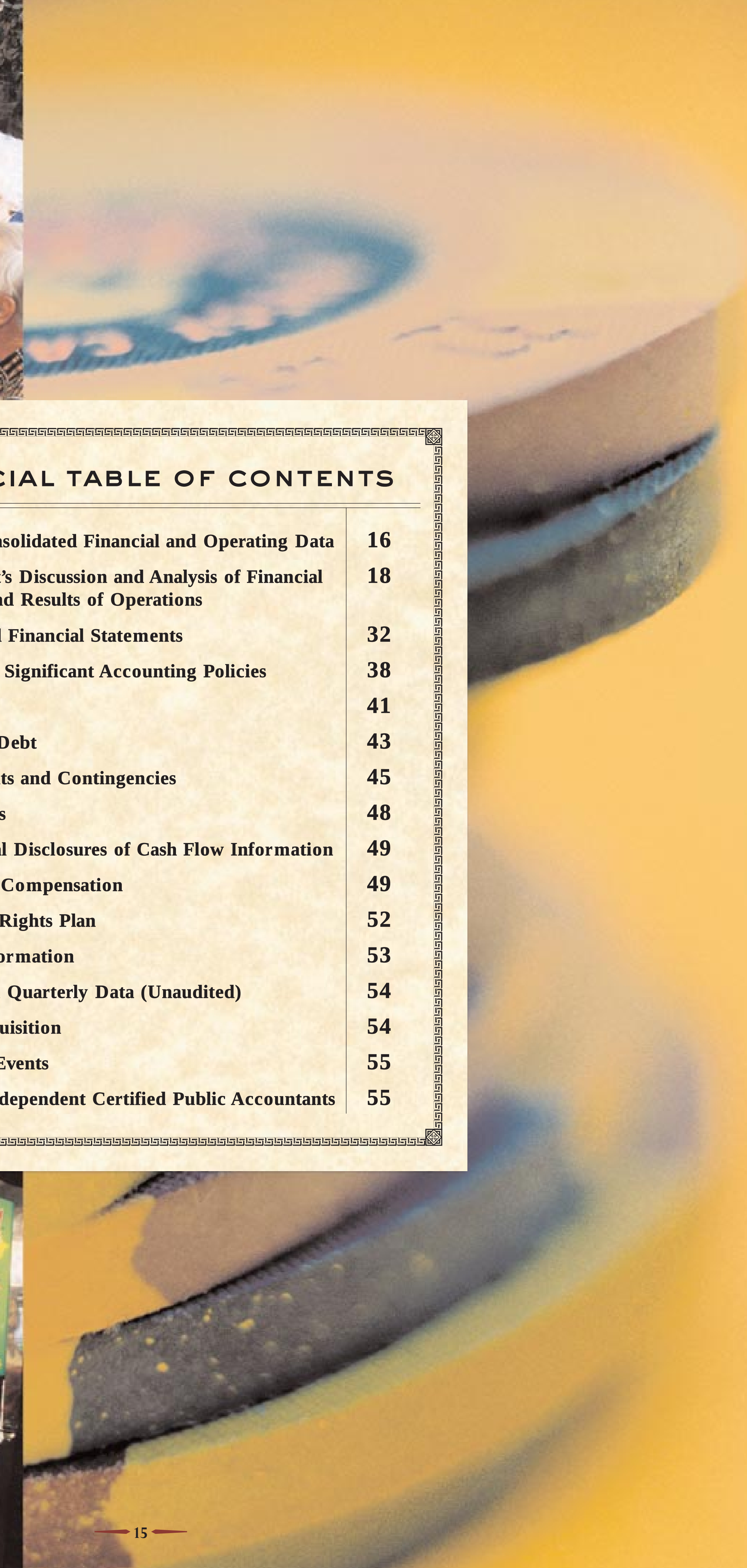


COLORADO

OH, THE WILD WEST!

IN AUGUST 2001, PENN NATIONAL AGREED TO ACQUIRE Bullwhackers Casino, the adjoining Bullpen Sports Casino and the Silver Saloon and Casino. With its prime location near both downtown Denver and Colorado's finest ski resorts, its Rocky Mountain locale draws many visitors. The anticipated closing of this transaction is the second quarter of 2002.





FINANCIAL TABLE OF CONTENTS

SELECTED CONSOLIDATED FINANCIAL AND OPERATING DATA

The following selected consolidated financial and operating data of Penn National Gaming, Inc. for the years ended December 31, 1997, 1998, 1999, 2000 and 2001 are derived from financial statements that have been audited by BDO Seidman, LLP, independent certified public accountants. The selected consolidated financial and operating data should be read in conjunction with the consolidated financial statements of Penn National and Notes thereto, "Management's Discussion and Analysis of Financial Condition and Results of Operations" and the other financial information included herein.

YEAR ENDED DECEMBER 31,	1997(1)	1998	1999	2000(2)	2001(3)
(In thousands, except per share data)					
Income statement data:(4)					
Revenue:					
Gaming	$ 5,730	$ 37,665	$ 55,415	$159,589	$366,166
Racing	98,402	106,850	102,827	113,230	112,243
Management service fee	–	–	–	–	8,297
Other	7,404	9,550	12,118	18,982	32,686
Total revenues	111,536	154,065	170,360	291,801	519,392
Operating expenses:					
Gaming	4,134	26,544	34,951	94,087	202,198
Racing	65,810	70,303	68,808	77,063	78,509
General and administrative	25,965	29,250	37,763	56,755	127,121
Other	5,623	8,080	11,173	18,776	33,852
Total operating expenses	101,532	134,177	152,695	246,681	441,680
Income from operations	10,004	19,888	17,665	45,120	77,712
Other income (expenses), net	(3,927)	(7,866)	(7,155)	(16,408)	(41,346)
Income before income taxes and extraordinary item	6,077	12,022	10,510	28,712	36,366
Taxes on income	2,308	4,519	3,777	10,137	12,608
Income before extraordinary item	3,769	7,503	6,733	18,575	23,758
Extraordinary item - loss on early extinguishment of debt, net of income taxes of $1,001 in 1997 and $4,615 in 2000	(1,482)	–	–	(6,583)	–
Net income	$ 2,287	$ 7,503	$ 6,733	$ 11,992	$ 23,758
Per share data:					
Basic income per share before extraordinary item	$0.25	$0.50	$0.45	$1.24	$1.55
Basic net income per share	$0.15	$0.50	$0.45	$0.80	$1.55
Diluted income per share before extraordinary item	$0.24	$0.49	$0.44	$1.20	$1.49
Diluted net income per share	$0.15	$0.49	$0.44	$0.78	$1.49
Weighted shares outstanding - basic	14,925	15,015	14,837	14,968	15,327
Weighted shares outstanding - diluted	15,458	15,374	15,196	15,443	15,918
Other data:					
Net cash provided by operating activities	$ 10,678	$ 11,866	$ 22,461	$ 41,813	$ 85,833
Net cash used in investing activities	(47,620)	(22,333)	(29,756)	(229,770)	(216,335)
Net cash provided by (used in) financing activities	53,162	(4,561)	9,903	201,810	145,593
Depreciation and amortization	3,771	5,318	7,733	12,039	32,093
Interest expense	4,860	8,804	9,613	20,644	46,097
EBITDA(5)	13,775	25,206	26,496	59,481	112,336
Capital expenditures	29,196	22,333	13,243	27,295	41,511

AS OF DECEMBER 31,	1997(1)	1998	1999	2000(2)	2001(3)
(In thousands)					
Balance sheet data:					
Cash and cash equivalents	$ 21,854	$ 6,826	$ 9,434	$ 23,287	$ 38,378
Total assets	158,878	160,798	189,712	439,900	679,377
Total debt	80,336	78,256	91,213	309,299	458,909
Shareholders' equity	53,856	59,036	66,272	79,221	103,265

(1) Reflects operations included since our January 15, 1997 acquisition of a joint venture interest in the Charles Town Entertainment Complex.

(2) Reflects operations included since the August 8, 2000 acquisition of Casino Magic Bay St. Louis casino and Boomtown Biloxi casino.

(3) Reflects operations included since the April 27, 2001 acquisition of all of the gaming assets of CRC Holdings, Inc. and the minority interest in Louisiana Casino Cruises, Inc.

(4) Certain prior year amounts have been reclassified to conform to the current year presentation.

(5) EBITDA consists of income from operations plus depreciation and amortization and earnings from joint venture. EBITDA is presented because we believe it is frequently used by securities analysts, investors and other interested parties in the evaluation of companies in our industry. However, other companies in our industry may calculate EBITDA differently than we do. EBITDA is not a measurement of financial performance under generally accepted accounting principles and should not be considered as an alternative to cash flow from operating activities or as a measure of liquidity or an alternative to net income as an indicator of operating performance or any other measure of performance derived in accordance with generally accepted accounting principles.

COMMON STOCK INFORMATION AND DIVIDEND POLICY

Our common stock is quoted on The Nasdaq National Market under the symbol "PENN." The following table sets forth for the periods indicated the high and low sales prices per share of our common stock as reported on The Nasdaq National Market.

2000	HIGH	LOW
First Quarter	$11.25	$ 6.81
Second Quarter	15.75	10.38
Third Quarter	15.38	12.50
Fourth Quarter	18.38	8.00

2001	HIGH	LOW
First Quarter	$15.13	$ 9.25
Second Quarter	26.20	10.88
Third Quarter	27.98	12.95
Fourth Quarter	30.65	16.02

Since our initial public offering of common stock in May 1994, we have not paid any cash dividends on our common stock. We intend to retain all of our earnings to fund our business, and thus, do not anticipate paying cash dividends on our common stock for the foreseeable future. Payment of any cash dividends in the future will be at the discretion of our Board of Directors and will depend upon, among other things, our future earnings, operations and capital requirements, our general financial condition and general business conditions. Moreover, our existing credit facility prohibits us from authorizing, declaring or paying any dividends until our commitments under the credit facility have been terminated and all amounts outstanding thereunder have been repaid. In addition, future financing arrangements may prohibit the payment of dividends under certain conditions.

MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS

OVERVIEW

We derive substantially all of our revenues from gaming and pari-mutuel operations. Since September 1997, revenues from our gaming machines at the Charles Town Entertainment Complex have accounted for an increasingly large share of our total revenues. Our pari-mutuel revenues have been derived from wagering on our live races, wagering on import simulcasts at our racetracks and OTWs and through telephone account wagering, and fees from wagering on export simulcasting our races at out-of-state locations. Our other revenues have been derived from admissions, program sales, food and beverage sales, concessions and certain other ancillary activities.

Our acquisitions of Casino Magic Bay St. Louis, Boomtown Biloxi, Casino Rouge and the management contract for Casino Rama will continue to impact our revenue mix between gaming and pari-mutuel revenues on a prospective basis. We expect that in future periods gaming revenue as a percentage of our total revenues will continue to increase as we continue to focus on our gaming operations. For the years ended December 31, 1999, 2000 and 2001, gaming revenue represented approximately 32%, 54% and 71% of our total revenue, respectively.

RECENT AND PENDING ACQUISITIONS

CASINO MAGIC AND BOOMTOWN BILOXI

On August 8, 2000, we completed our acquisition of the Casino Magic Bay St. Louis casino and the Boomtown Biloxi casino from Pinnacle Entertainment, Inc. for approximately $201.3 million in cash, including acquisition costs of $6.3 million. The purchase price was funded with a portion of the proceeds from our $350 million senior secured credit facility. As a result of the refinancing and repayment of existing debt, we recorded an $11.2 million pre-tax extraordinary charge, which was included in our results of operations for the year ended December 31, 2000. The results of operations for these properties from the period August 8, 2000 to December 31, 2001 are included in the results of operations discussed below.

CASINO ROUGE AND CASINO RAMA

On April 27, 2001, we completed our acquisition of Casino Rouge in Baton Rouge, Louisiana and the management contract for Casino Rama in Orillia, Ontario, Canada for approximately $182 million, including the repayment of existing debt of CRC and its subsidiaries. The purchase price of the acquisition was funded by the proceeds of our offering of 11⅛% senior subordinated notes due 2008, which was completed in March 2001. The results of operations for these properties for the period April 28, 2001 to December 31, 2001 are included in the results of operations discussed below.

BULLWHACKERS CASINO

In August 2001, we signed an agreement to acquire the operations of Bullwhackers Casino, the adjoining Bullpen Sports Casino and Silver Hawk Saloon and Casino in Black Hawk, Colorado for $6.5 million cash. We expect to close the acquisition in the second quarter of 2002.

CRITICAL ACCOUNTING POLICIES

Financial Reporting Release No. 60, which was recently released by the Securities and Exchange Commission, requires all companies to include a discussion of critical accounting policies or methods used in the preparation of financial statements. Our significant accounting policies are described in Note 1 of the Notes to the Consolidated Financial Statements. The significant accounting policies that we believe are the most critical to aid in fully understanding our reported financial results include the following:

REVENUE RECOGNITION

In accordance with common industry practice, our casino revenues are the net of gaming wins less losses. Racing revenues include our share of pari-mutuel wagering on live races after payment of amounts returned as winning wagers, and our share of wagering from import and export simulcasting as well as our share of wagering from our OTWs. The vast majority of wagers for both businesses are in the form of cash and we do not grant credit to our customers to a significant extent. Our receivables consist principally of amounts due from simulcasting of our races to other racetracks and their OTWs. We also have receivables due under our management contract with Casino Rama for management fees and for expenses, primarily salaries and wages, payable in accordance with our contract. Historically, we have not experienced any significant bad debts from uncollectable receivables.

RECENT ACCOUNTING STANDARDS

In June 2001, the Financial Accounting Standards Board finalized FASB Statements No. 141, "Business Combinations" ("SFAS 141") and No. 142, "Goodwill and Other Intangibles Assets" ("SFAS 142"). SFAS 141 requires the use of the purchase method accounting and prohibits the use of pooling-of-interests method of accounting for business combinations initiated after June 30, 2001. SFAS 141 also requires that we recognize acquired intangible assets apart from goodwill if the acquired intangible assets meet certain criteria. SFAS 141 applies to all business combinations initiated after June 30, 2001 and for purchase business combinations completed on or after July 1, 2001. It also requires, upon adoption of SFAS 142, that we reclassify the carrying amounts of intangible assets and goodwill based on certain criteria in SFAS 141.

SFAS 142 requires, among other things, that companies no longer amortize goodwill, but instead test goodwill for impairment at least annually. In addition, SFAS 142 requires that we identify reporting units for the purpose of assessing potential future impairments of goodwill, reassess the useful lives of the other existing recognized intangible assets, and cease amortization of intangible assets with an indefinite useful life. Any intangible asset with an indefinite useful life should be tested for impairment in accordance with the guidance in SFAS 142. SFAS 142 is required to be applied in fiscal years beginning after December 15, 2001 to all goodwill and other intangible assets recognized at that date, regardless of when those assets were initially recognized. SFAS 142 requires us to complete a transitional goodwill impairment test six months from the date of adoption. We are also required to reassess the useful lives of the other intangible assets within the first interim quarter after adoption of SFAS 142.

Our previous business combinations were accounted for using the purchase method. As of December 31, 2001, net carrying amount of goodwill is $160.2 million and other intangible assets (management service contract for Casino Rama) is $24.1 million. Amortization expense for goodwill and other intangible assets for the year ended December 31, 2001 was $3.5 million and $1.7 million, respectively. Currently, we are assessing but have not yet determined how the adoption of SFAS 142 will impact our financial position and results of operations.

In October 2001, the FASB issued SFAS No. 144, "Accounting for the Impairment or Disposal of Long-Lived Assets" ("SFAS 144"). This statement addresses financial accounting and reporting for the impairment or disposal of long-lived assets. This statement supersedes SFAS Statement No. 121, "Accounting for the Impairment of Long-Lived Assets and for Long-Lived Assets to Be Disposed Of," and the accounting and reporting provisions of APB Opinion No. 30, "Reporting the Results of Operations-Reporting the Effects of Disposal of a Segment of a Business, and Extraordinary, Unusual and Infrequently Occurring Events and Transactions." This statement also amends ARB No. 51 "Consolidated Financial Statements," to eliminate the exception to consolidation for a subsidiary for which control is likely to be temporary. This statement requires that one accounting model be used for long-lived assets to be disposed of by sale, whether previously held and used or newly acquired. This statement also broadens the presentation of discontinued operations to include more disposal transactions. SFAS 144 is effective for fiscal years beginning after December 15, 2001 and interim periods within those fiscal years. Currently, we are assessing but have not determined how the adoption of SFAS 144 will impact our financial position and results of operations.

RESULTS OF OPERATIONS

The results of operations by property level for the years ended December 31, 1999, 2000 and 2001 are summarized below (in thousands):

	REVENUES			EBITDA(1)		
	1999	2000	2001	1999	2000	2001
Charles Town Entertainment Complex	$ 80,015	$135,290	$193,612	$16,023	$35,469	$ 51,252
Casino Magic-Bay St. Louis(2)	–	31,571	87,752	–	6,092	18,658
Boomtown Biloxi(2)	–	24,634	70,370	–	3,460	13,546
Casino Rouge(3)	–	–	61,981	–	–	15,444
Casino Rama Management Contract(3)	–	–	8,297	–	–	7,632
Penn National Race Course and its OTWs	55,609	64,364	59,821	9,065	10,380	7,582
Pocono Downs and its OTWs	36,324	37,573	38,945	8,955	7,791	7,127
New Jersey Joint Venture	–	–	–	1,098	2,322	2,531
Corporate eliminations(4)	(1,588)	(1,631)	(1,386)	–	–	–
Corporate overhead	–	–	–	(5,361)	(6,033)	(9,946)
Corporate overhead CRC Holdings(3)	–	–	–	–	–	(490)
Total before non-recurring charges	170,360	291,801	519,392	29,780	59,481	113,336
Non-recurring charges and expenses	–	–	–	(3,284)	–	(1,000)
Total	$170,360	$291,801	$519,392	$26,496	$59,481	$112,336

(1) EBITDA consists of income from operations plus depreciation and amortization and earnings from joint venture. EBITDA is presented because we believe it is frequently used by securities analysts, investors and other interested parties in the evaluation of companies in our industry. However, other companies in our industry may calculate EBITDA differently than we do. EBITDA is not a measurement of financial performance under generally accepted accounting principles and should not be considered as an alternative to cash flow from operating activities or as a measure of liquidity or an alternative to net income as an indicator of operating performance, or any other measure of performance derived in accordance with generally accepted accounting principles.

(2) Reflects results since the August 8, 2000 acquisition from Pinnacle Entertainment.

(3) Reflects results since April 27, 2001 acquisition of CRC Holdings, Inc., including corporate overhead at CRC's executive office in Miami, Florida.

(4) Primarily reflects intracompany transactions related to import/export simulcasting.

YEAR ENDED DECEMBER 31, 2001 COMPARED TO YEAR ENDED DECEMBER 31, 2000

Revenues for the year ended December 31, 2001 increased by $227.6 million, or 78.0%, to $519.4 million in 2001 from $291.8 million in 2000. Revenues increased at our Mississippi properties by $101.9 million to $158.1 million in 2001 from $56.2 million in 2000 (which represented revenues from the August 8, 2000 acquisition date through December 31, 2000). The CRC properties, which were acquired on April 27, 2001, accounted for $70.3 million of the increase. Revenues also increased at the Charles Town Entertainment Complex by $58.3 million, or 43.1%, to $193.6 million in 2001 from $135.3 million in 2000 as a result of an increase in the number of gaming machines from 1,500 to 2,000 in 2001 and a higher percentage in 2001 of coin-out machines compared to video voucher machines. Revenues from the Pennsylvania racetracks and OTWs decreased by approximately $3.2 million due to a Commonwealth of Pennsylvania racing subsidy of $1.6 million received in 2000 but not in 2001 and a decrease in wagering.

Operating expenses for the year ended December 31, 2001 increased by $195.0 million, or 79.0%, to $441.7 million in 2001 from $246.7 million in 2000. Operating expenses increased at our Mississippi properties by $87.9 million to $138.4 million in 2001 from $50.5 million in 2000. The CRC properties also accounted for $54.3 million of the increase. Operating expenses increased at the Charles Town Entertainment Complex by $48.3 million, or 46.5%, to $152.2 million in 2001 from $103.9 million in 2000 due in large part to additional gaming machines in 2001 and a higher percentage of more expensive coin-out machines compared to video voucher machines. Operating expenses at the Pennsylvania racetracks and OTWs increased by $.4 million. Corporate overhead increased by $4.2 million, or 64.6%, to $10.7 million in 2001 from $6.5 million in 2000 primarily due to additional corporate staff needed to support the recent acquisitions.

EBITDA increased by $52.8 million, or 88.7%, to $112.3 million in 2001 from $59.5 million in 2000. EBITDA increased at our Mississippi properties by $22.6 million to $32.2 million in 2001 from $9.6 million in 2000. The CRC properties accounted for $22.6 million of the increase. EBITDA at the Charles Town Entertainment Complex increased by $15.8 million, or 44.5%, to $51.3 million in 2001 from $35.5 million in 2000. The Pennsylvania racetracks and OTWs and New Jersey joint venture EBITDA accounted for a decrease of $3.2 million over last year. Corporate overhead increased by $3.9 million, or 65.0%, to $9.9 million in 2001 from $6.0 million in 2000.

Net interest expense increased $24.3 million in 2001 due primarily to additional borrowings in August 2000 of approximately $200.0 million to finance the Mississippi acquisitions and $200.0 million in April 2001 to finance the CRC acquisition.

CHARLES TOWN ENTERTAINMENT COMPLEX

Total revenues for the year ended December 31, 2001 increased by $58.3 million, or 43.1%, to $193.6 million in 2001 from $135.3 million in 2000. Gaming revenues increased by $55.7 million, or 51.0%, to $165.0 million in 2001 from $109.3 million in 2000, primarily due to expansion of the gaming floor, which was completed in December 2000. As a result of the expansion, we added 500 reel-spinning, coin-out gaming machines, bringing the total average number of machines to approximately 2,000 for the year 2001, compared to approximately 1,500 gaming machines for the year 2000. These additional gaming machines, and the continued shift in machine mix to a higher percentage of reel-spinning, coin-out machines, resulted in an increase in average win per machine of $224 for the year ended December 31, 2001 compared to $199 for the year ended December 31, 2000. Racing revenues increased by $1.8 million, or 8.9%, to $22.1 million in 2001 from $20.3 million in 2000. This increase was primarily due to 25 additional racing days and an increase in export wagering by $43.1 million, or 28.2%, to $196.2 million as a result of additional racing days and overall larger per day wagering averages. Other revenue increased by $.8 million, or 14.0%, to $6.5 million in 2001 from $5.7 million in 2000 primarily as a result of higher food and beverage revenues from opening of the Sundance Café in November 2000, and expansion of the concession areas, dining room and the buffet.

Total operating expenses for the year ended December 31, 2001 increased $48.3 million, or 46.5%, to $152.2 million in 2001 from $103.9 million in 2000. The increase was primarily due to an increase in gaming and racing related taxes of $32.5 million attributable to increased gaming and racing revenues and a change in gaming legislation that resulted in higher gaming taxes and a higher net administrative fee paid to the State of West Virginia. Salaries and wages increased by $5.2 million primarily due to additional staffing associated with increased gaming units, gaming square footage, and expanded concession and dining facilities. Total marketing expenses increased $1.9 million in 2001 as a result of additional media advertising and promotional campaigns to increase awareness of the facility. Other expenses increased due to an increase in property insurance premiums and operating costs associated with the expanded capacity of the facility. Depreciation and amortization increased by $4.8 million as a result of higher capital expenditures in 2001. EBITDA for the year ended December 31, 2001 increased by $15.8 million, or 44.5%, to $51.3 million in 2001 from $35.5 million in 2000.

MISSISSIPPI CASINOS

Operating results in 2000 for Casino Magic Bay St. Louis and Boomtown Biloxi only include the period from August 8, 2000 through December 31, 2000. For the year ended December 31, 2001, Casino Magic Bay St. Louis had revenues of $87.8 million consisting mainly of gaming revenue. Operating expenses for Casino Magic totaled $76.5 million consisting of gaming ($44.0 million), other ($6.7 million), general and administrative ($18.4 million), and depreciation and amortization expense ($7.4 million). For the year ended December 31, 2001, Boomtown Biloxi had revenues of $70.4 million consisting mainly of gaming revenue. Operating expenses for Boomtown totaled $61.8 million consisting of gaming ($28.9 million), other ($8.8 million), general and administrative ($19.1 million), and depreciation and amortization expense ($5.0 million). EBITDA for the Mississippi casinos totaled $32.2 million for the period. Our Mississippi casino operations have numerous competitors, many of which have greater name recognition and financial and marketing resources than we do. Competition in the Mississippi gaming markets is significantly more intense than the competition that our gaming operations face in West Virginia or our pari-mutuel operations face in Pennsylvania and New Jersey.

CASINO ROUGE AND CASINO RAMA

The CRC acquisition was completed on April 27, 2001 and includes the purchase of Casino Rouge in Baton Rouge, Louisiana, and a management contract to operate Casino Rama in Orillia, Canada. For the period from April 28, 2001 to December 31, 2001, Casino Rouge had revenues of $62.0 million consisting mainly of gaming revenues. Operating expenses for Casino Rouge totaled $51.3 million consisting of gaming ($29.4 million), other ($3.4 million), general and administrative ($13.8 million) and depreciation and amortization expense ($4.7 million). For the period from April 28, 2001 to December 31, 2001, management fees from the Casino Rama management contract totaled $8.3 million for which there was $.7 million of direct operating expenses relating to the associated revenues and amortization of $1.7 million related to the management services contract. EBITDA for Casino Rouge and Casino Rama totaled $22.6 million for the same period.

PENN NATIONAL RACE COURSE AND ITS OTW FACILITIES

Revenues for the year ended December 31, 2001 decreased by $4.6 million, or 7.1%, to $59.8 million in 2001 from $64.4 million in 2000. Live racing revenue accounted for $1.4 million of the decrease as a result of a decline in attendance, inclement weather and smaller fields in the first five months of 2001. Full card simulcasting accounted for $2.0 million of the $4.6 million decline, again due to lower attendance in 2001. Other racing revenue declined by $1.0 million in 2001 compared to 2000 as a result of a Commonwealth of Pennsylvania racing subsidy received in 2000 but not in 2001. Although the Commonwealth passed a similar subsidy measure in 2001, subsidy payments by the Commonwealth were frozen and were not received.

Operating expenses for the year ended December 31, 2001 decreased by $1.8 million, or 3.2%, to $55.7 million in 2001 from $55.8 million in 2000. Racing-related expenses such as purses, simulcast fees and pari-mutuel taxes declined by $1.6 million, in part due to lower racing revenues. EBITDA for the year ended December 31, 2001 decreased by $2.8 million, or 26.9%, to $7.6 million in 2001 from $10.4 million in 2000.

POCONO DOWNS AND ITS OTW FACILITIES

Revenues for the year ended December 31, 2001 increased by $1.3 million, or 3.4%, to $38.9 million in 2001 from $37.6 million in 2000. Revenues increased approximately $2.3 million due to the opening of a new OTW facility in East Stroudsburg, Pennsylvania, that was in operation for all of 2001 compared to five months in 2000. This increase was offset by a decline of $.6 million as a result of a Commonwealth of Pennsylvania racing subsidy received in 2000 but not in 2001, and a net decline in revenues at the other Pocono Downs OTWs.

Operating expenses for the year ended December 31, 2001 increased by $2.3 million, or 7.2%, to $34.2 million in 2001 from $31.9 million in 2000. Other operating expenses, administrative expense and concessions expenses increased $.9 million to $11.6 million compared to $10.7 million for the same period the previous year due to a full year of operations at the East Stroudsburg OTW. Racing-related expenses, such as purses, simulcast fees and pari-mutuel taxes, increased $1.0 million, in part due to higher racing revenues. For the year ended December 31, 2001 EBITDA decreased by $.7 million to $7.1 million in 2001 from $7.8 million in 2000.

CORPORATE OVERHEAD EXPENSES

Corporate overhead expenses increased by $4.2 million, or 64.6%, to $10.7 million in 2001 from $6.5 million in 2000. Salaries and wages, payroll taxes, employee benefits, relocation expenses and office rent increased by $2.0 million due to the addition of new staff at the corporate office to support the Mississippi and CRC acquisitions. Liability insurance increased by $.5 million due to increased limits for general liability, fiduciary and directors and officers liability insurance and increased insurance rates as a result of market conditions. Consulting and professional services increased by $1.0 million due to acquisition-related activities and regulatory expenses. Travel expenses increased by $.4 million as a result of supporting properties in Mississippi, Louisiana and Canada.

NEW JERSEY JOINT VENTURE

We have an investment in Pennwood Racing, Inc., which operates Freehold Raceway in New Jersey and, until May 2001, operated Garden State Park. In May 2001, Garden State Park was sold and the joint venture ceased operating Garden State Park. Our 50% share of net income was $2.5 million in 2001 compared to $2.3 million in 2000 and was recorded as other income on the income statement. The increase in the joint venture's net income is due in part to impairment expenses recorded in December 2000 related to the then-proposed May 2001 closure of Garden State Park and decreased interest expense in 2001, offset by the decrease in operating income in 2001 as a result of the closure of Garden State Park.

NON-RECURRING CHARGES AND EXPENSES

Non-recurring charges and expenses for the year ended December 31, 2001 were $1.0 million as a result of the settlement of the Showboat litigation.

YEAR ENDED DECEMBER 31, 2000 COMPARED TO YEAR ENDED DECEMBER 31, 1999

Revenues for the year ended December 31, 2000 increased 71.2% or $121.4 million to $291.8 million, from $170.4 for the year ended December 31, 1999. Operating expenses increased 61.6%, or $94.6 million, to $248.2 million in 2000, from $153.6 million in 1999. The increases in revenues and operating expenses were primarily a result of the Casino Magic and Boomtown Biloxi acquisition in August 2000, the change to more reel-spinning, coin-out gaming machines at the Charles Town Entertainment Complex and the addition of 500 new machines at Charles Town. As a result, income from operations increased 160.5%, or $26.8 million, to $43.5 million in 2000 from $16.7 million in 1999. Total other expense increased 138.7%, or $8.6 million, to $14.8 million in 2000 from $6.2 million in 1999. Net interest expenses increased $9.9 million in 2000 due to additional borrowings of $200 million to finance the Mississippi acquisition. Earnings from the New Jersey joint venture increased by $1.2 million compared to 1999. Taxes on income increased by 168.4%, or $6.4 million, due to the factors discussed above. Income before extraordinary item was $18.6 million in 2000 compared to net income of $6.7 million in 1999. In 2000, we incurred an extraordinary charge net of taxes of $6.6 million for the early extinguishment of debt; after giving effect to this change, our net income was $12.0 million for the year ended December 31, 2000.

CHARLES TOWN ENTERTAINMENT COMPLEX

Revenues increased at Charles Town by approximately $55.3 million, or 69.1%, to $135.3 million in 2000 from $80.0 million in 1999. Gaming revenue increased by $53.9 million, or 97.3%, to $109.3 million in 2000 from $55.4 million in 1999 due to the addition of 136 new video lottery machines in mid-1999, 565 new reel-spinning, coin-out gaming machines in late 1999 and 452 gaming machines in the OK Corral slots center, which opened on November 25, 2000. The average number of machines in play increased to 1,494 in 2000 from 923 in 1999 and the average win per machine increased to $199 in 2000 from $163 in 1999. Racing revenue increased by $1.0 million, or 5.2%, to $20.3 million in 2000 from $19.3 million in 1999. This increase is due primarily to a change in the schedule from a Wednesday afternoon race program to a Thursday evening race program in 2000 to accommodate export simulcasting. Charles Town began exporting its live race program to tracks across the country on June 5, 1999 and generated export simulcasting revenues of $2.2 million in 2000 compared to $1.0 million in 1999. Operating expenses increased by $36.5 million, or 54.2%, to $103.9 million in 2000 from $67.4 million in 1999. The increase was primarily due to an increase in gaming expenses of $30.1 million, or 86.0%, to $65.1 million in 2000 from $35.0 million in 1999. This increase was mainly due to increased lottery taxes, purses, salaries and wages and administrative expenses related to the increase in gaming revenues. Racing, other and general and administrative expenses increased by $4.1 million, or 13.4%, to $34.7 million in 2000 from $30.6 million in 1999. The increase was due to an increase in direct costs associated with additional wagering on horse racing and gaming machine play, the addition of gaming machines and floor space (new temporary facility for gaming machines and the opening of the OK Corral slot center), export simulcast expenses and expanded concession and dining capability and capacity. Depreciation expense increased by $2.3 million, or 127.8%, to $4.1 million in 2000 from $1.8 million in 1999 due to additional gaming machines and improvements in 2000. EBITDA attributable to Charles Town increased by $19.5 million, or 121.9%, to $35.5 million in 2000 from $16.0 million in 1999.

MISSISSIPPI CASINOS

The Casino Magic Bay St Louis and Boomtown Biloxi acquisitions were completed on August 8, 2000. For the period August 8 to December 31, 2000, Casino Magic Bay St. Louis had revenues of $31.6 million consisting mainly of gaming revenue. Operating expenses for Casino Magic totaled $27.8 million consisting of gaming ($18.0 million), other ($2.5 million), general and administrative ($5.0 million), and depreciation and amortization expense ($2.3 million). For the period August 8 to December 31, 2000 Boomtown Biloxi had revenues of $24.6 million consisting mainly of gaming revenue. Operating expenses for Boomtown totaled $22.7 million consisting of gaming ($11.0 million), other ($3.2 million), general and administrative ($7.0 million), and depreciation and amortization expense ($1.5 million). EBITDA for the Mississippi casinos totaled $9.6 million for the period. Our Mississippi casino operations have numerous competitors, many of which have greater name recognition and financial and marketing resources than we do. Competition in the Mississippi gaming markets is significantly more intense than the competition that our gaming operations face in West Virginia or our pari-mutuel operations face in Pennsylvania and New Jersey.

PENN NATIONAL RACE COURSE AND ITS OTW FACILITIES

Penn National Race Course had an increase in revenue of approximately $8.8 million, or 15.8%, to $64.4 million in 2000 from $55.6 million in 1999. Pari-mutuel wagering was $386.6 million in 2000 compared to $333.8 million in 1999. The increase in wagering and revenues is attributed to Penn National Race Course running 201 live race days in 2000 compared to 153 live races days in 1999. Penn National only ran 153 live race days in 1999 due to the Horsemen action in the first quarter that resulted in the closure of all of the facilities from February 16 to March 24, 1999. Operating expenses increased by approximately $6.2 million, or 12.5%, to $55.8 million in 2000 from $49.6 million in 1999. The increase was primarily due to an increase in racing expenses of $5.6 million, or 16.0%, to $40.5 million in 2000 from $34.9 million in 1999. This increase was due to the temporary closure of Penn National Race Course and its OTWs in 1999 and a limited live race schedule during a portion of 1999 due to the Horsemen action described above. Adjusting for the Horsemen action in 1999, EBITDA attributable to these properties increased by $1.3 million, or 14.3%, to $10.4 million in 2000 from $9.1 million in 1999.

POCONO DOWNS AND ITS OTW FACILITIES

Revenues at Pocono Downs increased by $1.3 million, or 3.6%, to $37.6 million in 2000 from $36.3 million in 1999. Pari-mutuel wagering was $161.6 million in 2000 compared to $160.2 million in 1999. Operating expenses increased by approximately $2.4 million, or 8.1%, to $31.9 million in 2000 from $29.5 million in 1999. The increase was primarily due to an increase in racing expenses of $2.0 million, or 9.9%, to $22.3 million in 2000 from $20.3 million in 1999. The opening of the new OTW facility in East Stroudsburg, Pennsylvania, and the increase in purse expense per the terms of the new Horsemen's contract executed in January 2000 accounted for most of the increase in expenses. EBITDA decreased $1.2 million, or 13.3%, to $7.8 million in 2000 from $9.0 million in 1999.

CORPORATE OVERHEAD EXPENSES

Corporate overhead expenses increased by $0.7 million, or 13.2%, to $6.0 million in 2000 from $5.3 million in 1999. Salaries and wages, payroll taxes, and benefits increased by $0.7 million due to new positions created for business development, employee training, and marketing. Expenses also increased for SEC and annual reporting ($73,000), office space ($30,000) and corporate travel for acquisitions and Mississippi operations ($246,000). These increases were partially offset by a decrease in outside services, professional fees and consulting fees in the amount of $0.4 million.

NEW JERSEY JOINT VENTURE

We completed our investment in Pennwood Racing, Inc., the New Jersey joint venture, on July 29, 1999. Pennwood Racing operates Freehold Raceway and Garden State Park. Revenues of the joint venture increased to $61.5 million in 2000 from $28.0 million in 1999 as a result of the operating results in 2000 reflecting a full twelve-month period. Net income was $5.6 million in 2000, before non-recurring charges of $1.0 million relating to the termination of the Garden State lease, compared to $2.2 million in 1999. Our 50% share of net income was $2.3 million, after a non-recurring charge of $0.5 million, in 2000 compared to $1.1 million in 1999.

NON-RECURRING CHARGES AND EXPENSES

Non-recurring charges and expenses totaled $3.3 million for the year ended December 31, 1999. In connection with our gaming operations in West Virginia, we recorded litigation expense of $1.5 million for liquidated damages awarded to Amtote International, Inc. in a wagering services contract dispute. In Tennessee, the Tennessee Supreme Court declined to review the substantive issue of whether pari-mutuel wagering on horse racing is lawful under the existing statute without the Tennessee Racing Commission. As a result of this decision we recorded a charge against earnings of $0.5 million for costs incurred for our Tennessee racing license. In Pennsylvania, we incurred expenses totaling $1.3 million as a result of the Horsemen's action that closed Penn National Race Course and its OTWs from February 16 to March 24, 1999 and resulted in the loss of 46 race days in 1999.

LIQUIDITY AND CAPITAL RESOURCES

Historically, our primary sources of liquidity and capital resources have been cash flow from operations, borrowings from banks and proceeds from the issuance of debt and equity securities.

Net cash provided by operating activities was $85.8 million for the year ended December 31, 2001. This consisted of net income ($24.4 million), adjusted for non-cash reconciling items ($36.8 million) and net increases in current liability accounts along with net decreases in current asset accounts ($24.6 million), net of assets and liabilities acquired in the CRC acquisition. Net income, non-cash items and the net change in the balance sheet accounts increased by $12.4 million, $12.3 million and $19.1 million, respectively, in 2001 as compared to 2000.

Cash flows used in investing activities totaled $216.3 million for the year ended December 31, 2001. Expenditures for property, plant, and equipment totaled $41.5 million and included renovations of the buffet restaurant and new hotel construction at Casino Magic Bay St. Louis ($18.0 million), new gaming equipment at Casino Magic ($1.6 million), new gaming equipment and slot system at Boomtown Biloxi ($2.4 million), land and building acquisitions at the Charles Town Entertainment Complex ($1.0 million), the OK Corral slot center at Charles Town ($0.6 million), property additions at Charles Town ($0.3 million), construction of parking garage and expansion at Charles Town ($3.2 million), construction and design of a steak house at Casino Rouge ($1.6 million), other small projects ($1.3 million) and maintenance capital expenditures at our properties ($11.5 million). The CRC acquisition totaled $182.7 million. Cash received from the New Jersey joint venture totaled $2.9 million. Cash in escrow decreased by $4.6 million as a result of the closing of the CRC acquisition on April 27, 2001.

Cash flows from financing activities provided net cash flow of $145.6 million for the year ended December 31, 2001. Aggregate proceeds from the issuance of notes were $200.0 million, a portion of which were used to pay financing costs associated with the issuance ($6.9 million). Principal payments on long-term debt under our existing credit facility, net of additional borrowings on the revolving line of credit, were $50.4 million. Proceeds from the exercise of stock options totaled $2.9 million.

CAPITAL EXPENDITURES

The following table summarizes our planned capital expenditures, other than maintenance capital expenditures, by property level for fiscal years ended December 31, 2002 and 2003:

YEAR ENDING DECEMBER 31,	2002	2003
(in thousands)		
Property		
Charles Town Entertainment Complex	$41,400	$10,000
Casino Magic Bay St. Louis	20,700	-
Boomtown Biloxi	-	4,500
Bullwhackers Casino(1)	9,000	-
Totals	$71,100	$14,500

(1) Pending acquisition.

Beginning in late 2001 and continuing through the end of 2002, we expect to expend significant amounts on capital expenditures at the Charles Town Entertainment Complex and Casino Magic Bay St. Louis. At Charles Town, we expect to spend an additional $41.4 million in 2002 on capital expenditures that were begun in 2001. Specifically, we expect to complete construction of a structured parking facility, at an estimated additional cost of $10.2 million in 2002, and expand the gaming and entertainment facility at Charles Town, at an estimated cost of $31.2 million in 2002, which includes the purchase of 500 additional gaming machines. In 2003, we expect to expend approximately $10.0 million to purchase and install an additional 1,000 machines at Charles Town. On February 28, 2002, the West Virginia Lottery Commission approved our request to add up to 1,500 additional gaming machines to the 2,000 machines already in place at Charles Town. Depending on future market conditions in the West Virginia gaming market, we will continue to evaluate our plans to build a 300-room hotel at Charles Town.

At Casino Magic, we have begun construction of a 300-room hotel with meeting and conference facilities, three new restaurant venues, renovations to the existing buffet restaurant and certain amenities to the gaming floor. Through December 31, 2001, we spent approximately $18.0 million on these projects. In 2002, we expect to spend an additional $20.7 million to complete these projects.

In January 2002, we signed an option to purchase approximately 4 acres of land adjacent to our Boomtown Biloxi property for $4.0 million. The purchase is contingent upon receiving certain governmental and third-party consents, authorizations, approvals and licenses which we expect could occur in 2003. If successful, we expect to use the land for additional parking for our Boomtown facility. In addition, we expect to make certain property improvements in 2003 at Boomtown at a cost of approximately $0.5 million.

On August 30, 2001, we entered into a definitive agreement to acquire all of the assets of the Bullwhackers Casino operations, in Black Hawk, Colorado, from Colorado Gaming and Entertainment Co., a subsidiary of Hilton Group plc, for $6.5 million in cash. The Bullwhackers assets consist of the Bullwhackers Casino, the adjoining Bullpen Sports Casino, the Silver Hawk Saloon and Casino, an administrative building and a 475-car parking area, all located in Black Hawk, Colorado. The Bullwhackers properties comprise a total of 63,800 square feet of interior space, 20,700 square feet of which is devoted to gaming, consisting of 1,002 slot machines and 16 table games. The properties are located on leased land as well as 3.25 acres of land included in the acquisition, much of which is utilized for parking. We currently expect that the transaction will close in the second quarter of 2002. As of December 31, 2001, we had made a deposit of $500,000 under the terms of the agreement. In the year 2002, we expect to spend $9.0 million for the acquisition, closing costs and improvements to the Bullwhackers Casino.

For 2002 and 2003, we expect to expend approximately between $14.0 million and $16.0 million each year for maintenance capital expenditures at our properties.

We expect to use cash generated from operations and cash available under the revolver portion of our existing senior secured credit facility to fund our anticipated capital expenditure and maintenance capital expenditures in 2002 and 2003. See “Outlook” below.

SENIOR SECURED CREDIT FACILITY

On August 8, 2000, we entered into a $350 million senior secured credit facility with a syndicate of lenders led by Lehman Brothers Inc. and CIBC World Markets Corp. that replaced our then-existing credit facilities. The credit facility is comprised of a $75 million revolving credit facility maturing on August 8, 2005, a $75 million Tranche A term loan maturing on August 8, 2005 and a $200 million Tranche B term loan maturing on August 8, 2006. Up to $10 million of the revolving credit facility may be used for the issuance of standby letters of credit, of which there was $2.6 million outstanding as of December 31, 2001. In addition, up to $10 million of the revolving credit facility also may be used for short-term credit to be provided to us on a same-day basis, which must be repaid within five days.

At our option, the revolving credit facility and the Tranche A term loan may bear interest at (1) the highest of ½ of 1% in excess of the federal funds effective rate or the rate that the bank group announces from time to time as its prime lending rate plus an applicable margin of up to 2.25%, or (2) a rate tied to a eurodollar rate plus an applicable margin up to 3.25%, in either case with the applicable rate based on our total leverage. At our option, the Tranche B term loan may bear interest at (1) the highest of ½ of 1% in excess of the federal funds effective rate or the rate that the bank group announces from time to time as its prime lending rate plus an applicable margin of up to 3.25%, or (2) a rate tied to a eurodollar rate plus an applicable margin up to 4.00%, in either case with the applicable rate based on our total leverage. The eurodollar rate is defined as the rate that appears on page 3750 of the Dow Jones Telerate Screen as of 11:00 a.m. London time two days before the applicable funding date (adjusted for statutory reserve requirements for eurocurrency liabilities) at which eurodollar deposits for one, two, three or six months, as selected by us, are offered in the interbank eurodollar market. At December 31, 2001, the weighted average loan rate for the Tranche A and Tranche B loans was 8.4%. In addition, as of December 22, 2000, we entered into a $100.0 million interest rate swap contract obligating us to pay a fixed rate of 5.825% against a variable interest rate based on the 90-day LIBOR rate, which expires on December 22, 2003. On August 3, 2001, we entered into a $36.0 million interest rate swap contract obligating us to pay a fixed rate of 4.8125% against a variable interest rate based on the 90-day LIBOR rate, which expires on June 30, 2004.

As of December 31, 2001, $61.9 million was outstanding on the Tranche A term loan, $197.0 million was outstanding on the Tranche B term loan and there was no outstanding balance under the revolving credit portion of the facility. Proceeds from the credit facility to date have been used to finance the acquisition of the Mississippi properties, to replace our existing term loan and revolving credit facilities, to complete a tender offer for our 1997 senior notes and for working capital purposes.

11 1/8% SENIOR SUBORDINATED NOTES DUE 2008

On March 12, 2001, we completed a private offering of $200,000,000 of our 11⅛% senior subordinated notes due 2008. The net proceeds of the 11⅛% notes were used, in part, to finance our acquisition of Casino Rouge and the management contract at Casino Rama, including the repayment of certain existing indebtedness at CRC. Interest on the 11⅛% notes is payable on March 1 and September 1 of each year. The 11⅛% notes mature on March 1, 2008. As of February 28, 2002, all of the principal amount of the 11⅛% notes are outstanding.

We may redeem all or part of the 11⅛% notes on or after March 1, 2005 at certain specified redemption prices. Prior to March 1, 2004, we may redeem up to 35% of the 11⅛% notes from proceeds of certain sales of our equity securities. The 11⅛% notes also are subject to redemption requirements imposed by state and local gaming laws and regulations.

The 11⅛% notes are general unsecured obligations and are guaranteed on a senior subordinated basis by certain of our current and future wholly-owned domestic subsidiaries.

The 11⅛% notes rank equally with our future senior subordinated debt and junior to our senior debt, including debt under our senior credit facility. In addition, the 11⅛% notes will be effectively junior to any indebtedness of our non-U.S. or unrestricted subsidiaries, none of which have guaranteed the 11⅛% notes.

The 11⅛% notes and guarantees were originally issued in a private placement pursuant to an exemption from the registration requirements of the Securities Act of 1933. On July 30, 2001, we completed an offer to exchange the 11⅛% notes and guarantees for 11⅛% notes and guarantees registered under the Securities Act having substantially identical terms.

RECENT FINANCING TRANSACTIONS

EQUITY OFFERING

On February 20, 2002, we completed a public offering of 4,600,000 shares of our common stock at a public offering price of $30.50 per share. Of the common shares sold in the offering, 3,350,000 shares were sold by us and 1,250,000 shares were sold by The Carlino Family Trust, a related party. We have used the net proceeds from the offering, totaling approximately $96.1 million after deducting underwriting discounts and related expenses, to repay term loan indebtedness under the existing senior secured credit facility. We did not receive any proceeds from the offering by The Carlino Family Trust.

8⅞% SENIOR SUBORDINATED NOTES DUE 2010

On February 28, 2002, we completed a public offering of $175,000,000 of our 8⅞% senior subordinated notes due 2010. Interest on the 8⅞% notes is payable on March 15 and September 15 of each year, beginning September 15, 2002. The 8⅞% notes mature on March 15, 2010. As of February 28, 2002, all of the principal amount of the 8⅞% notes is outstanding. We have used the net proceeds from the offering, totaling approximately $170.1 million after deducting underwriting discounts and related expenses, to repay term loan indebtedness under the existing senior secured credit facility.

We may redeem all or part of the 8⅞% notes on or after March 15, 2006 at certain specified redemption prices. Prior to March 15, 2005, we may redeem up to 35% of the 8⅞% notes from proceeds of certain sales of our equity securities. The 8⅞% notes also are subject to redemption requirements imposed by state and local gaming laws and regulations.

The 8⅞% notes are general unsecured obligations and are guaranteed on a senior subordinated basis by certain of our current and future wholly-owned domestic subsidiaries. The 8⅞% notes rank equally with our future senior subordinated debt, including the 11⅛% senior subordinated notes, and junior to our senior debt, including debt under our senior credit facility. In addition, the 8⅞% notes will be effectively junior to any indebtedness of our non-U.S. or unrestricted subsidiaries, none of which have guaranteed the 8⅞% notes.

Although we repaid the term indebtedness under the existing senior secured credit facility, we did not cancel the related interest rate swap agreements. We continue to maintain these agreements. The changes in the fair values of the interest rate swaps as well as the amortization of the amounts recorded in other comprehensive income will be recognized as components of interest expense subsequent to the payoff of the floating rate debt.

COMMITMENTS AND CONTINGENCIES

CONTRACTUAL CASH OBLIGATIONS

As discussed above, in February 2002 we completed public offerings of common stock and 8⅞% senior subordinated notes and used the proceeds of those offerings to repay the outstanding term loan indebtedness under the senior secured credit facility. As of March 8, 2002, there was no indebtedness outstanding under the credit facility and there was approximately $71.0 million available for borrowing under the revolving credit portion of the credit facility. The following table reflects these recent offerings and the repayment of the senior secured credit facility as of March 8, 2002.

		PAYMENTS DUE BY PERIOD			
	TOTAL	2002	2003-2004	2005-2006	2007 & AFTER
(In thousands)					
Senior secured credit facility(1)	$ –	$ –	$ –	$ –	$ –
11 1/8% senior subordinated notes due 2008(2)					
Principal	200,000	–	–	–	200,000
Interest	159,458	22,250	44,500	44,500	48,208
8 7/8% senior subordinated notes due 2010(3)					
Principal	175,000	–	–	–	175,000
Interest	124,248	7,766	31,063	31,063	54,356
Operating leases	11,929	3,530	5,474	1,978	947
Bullwhackers Casino purchase agreement	6,500	6,500	–	–	–
Total	$677,135	$40,046	$81,037	$77,541	$478,511

(1) Subsequent to December 31, 2001, we completed public offerings of common stock and 8 7/8% senior subordinated notes and used the proceeds of those offerings to repay the outstanding term loan indebtedness under the credit facility. As of March 8, 2002, there was no indebtedness outstanding under the credit facility and there was approximately $71.0 million available for borrowing under the revolving credit portion of the credit facility.

(2) The $200.0 million aggregate principal amount of 11 1/8% notes matures on March 1, 2008. Interest payments of approximately $11.1 million are due on each March 1 and September 1 until March 1, 2008.

(3) The $175.0 million aggregate principal amount of 8 7/8% notes matures on March 15, 2010. Interest payments of approximately $7.8 million are due on each March 15 and September 15 until March 15, 2010.

OTHER COMMERCIAL COMMITMENTS

The following table presents our material commercial commitments as of March 8, 2002 for the following future periods:

		AMOUNT OF COMMITMENT EXPIRATION PER PERIOD			
	TOTAL AMOUNTS COMMITTED	2002	2003-2004	2005-2006	2007 & AFTER
(In thousands)					
Revolving Credit Facility(1)	$70,600	$ -	$ -	$70,600	$ -
Letters of Credit(1)	4,400	4,400	-	-	-
Guarantees of New Jersey Joint Venture Obligations(2)	10,400	767	9,633	-	-
Total	$85,400	$5,167	$9,633	$70,600	$ -

(1) The available balance under the revolving portion of the $75.0 senior secured credit facility is diminished by outstanding letters of credit.

(2) In connection with our 50% ownership interest in Pennwood Racing, our joint venture in New Jersey, we have entered into a debt service maintenance agreement with Pennwood's lender to guarantee up to 50% of Pennwood's $23.0 million term loan. Our obligation as of March 8, 2002 under this guarantee is approximately $10.4 million.

LITIGATION

On August 20, 2001, Showboat Development Company brought a lawsuit against us and certain other parties related to the Charles Town Entertainment Complex. The suit alleges, among other things, that our operation of coin-out video lottery terminals at the Charles Town facility constitutes the operation of a casino, thereby triggering Showboat's option to manage the casino. The suit also alleges that our March 2000 acquisition of the 11% minority interest in Charles Town Races from BDC Group, our former joint venture partner, was made in violation of a right of first refusal that Showboat holds from BDC covering the sale of any interest in any casino at Charles Town Races. We filed in federal district court in Nevada a motion to dismiss this action for lack of personal jurisdiction and, in the alternative, a motion to transfer the case to the state of West Virginia. On January 25, 2002, the district court granted our motion to dismiss. On February 13, 2002, Showboat filed a lawsuit in the United States District Court for the Eastern District of Pennsylvania. The substance of the lawsuit was substantially similar to Showboat's previous claim filed in Nevada. On March 28, 2002, Penn National and Showboat agreed to settle all litigation related to this matter. Under the settlement, we agreed to make a one-time payment of $1.0 million to Showboat, which was recognized in general and administrative expenses in our operating results for the fourth quarter of 2001.

In July 2001, a lawsuit was filed against us by certain surveillance employees at the Charles Town facility claiming that our surveillance of those employees during working hours was improper. The lawsuit claims damages of $7.0 million and punitive damages of $15.0 million. We currently are conducting discovery in the case but, at this time, believe that all of the claims of the employees are without merit. On February 12, 2002, we filed a motion for summary judgment that is pending before the court. We intend to vigorously defend ourselves against this action and do not believe that this action will have a material adverse effect on our financial condition or results of operations.

In January 2002, an employee at our Charles Town facility initiated a suit against us alleging invasion of privacy. The employee claims in the suit that she was subjected to an involuntary strip search by other Charles Town employees as part of a theft investigation and is seeking punitive damages. The lawsuit claims damages of $0.5 million and punitive damages of $3.5 million. We believe we have meritorious defenses and intend to vigorously defend ourselves against this suit.

We also are parties to certain other litigation but do not believe it will have a material adverse effect on our financial condition or results of operations if any of these legal proceedings were adversely adjudicated or settled. Furthermore, the nature of our business subjects us to the risk of lawsuits filed by customers and others in the ordinary course. In general, litigation can be expensive and time consuming to defend and could result in settlements or damages that could significantly impact results of operations or financial condition.

INTEREST RATE SWAP AGREEMENTS

We currently use interest rate swaps to assist in managing interest incurred on our long-term debt. The difference between amounts received and amounts paid under such agreements, as well as any costs or fees, is recorded as a reduction of, or addition to, interest expense as incurred over the life of the swap or similar financial instrument. On December 20, 2000, we entered into a forward interest rate swap with a notional amount of $100 million, which has an effective date of December 22, 2000 and a termination date of December 22, 2003. Under this agreement, we pay a fixed rate of 5.835% against a variable interest rate based on the 90-day LIBOR rate. On August 3, 2001, we entered into a forward interest rate swap with a notional amount of $36 million, which has an effective date of August 7, 2001 and a termination date of June 30, 2004. Under this agreement, we pay a fixed rate of 4.8125% against a variable interest rate based on the 90-day LIBOR rate. At December 31, 2001, the 90-day LIBOR rate was 1.92%. We entered into these interest rate swap agreements to reduce the impact of future variable interest payments related to our senior secured credit facility. We account for the interest rate swap agreements as cash flow hedges. The changes in the fair values of the interest rate swaps are recorded as adjustments to accrued interest in the accompanying consolidated balance sheet with the offset recorded in accumulated other comprehensive loss, which as of December 31, 2001 amounted to $3.8 million, net of an income tax benefit of $2.0 million. Any hedge ineffectiveness was not material for the year ended December 31, 2001. Amounts recorded in accumulated other comprehensive income will be amortized as an adjustment to interest expense over the term of the related derivative. We estimate $1.8 million of net derivative losses included in other comprehensive income will be reclassified into interest expense within the next twelve months.

The interest rate swap agreements hedge a portion of our exposure on our outstanding floating rate obligations, which were $258.9 million at December 31, 2001. For the year ended December 31, 2001, we increased interest expense by approximately $1.7 million as a result of the interest rate swap agreements. We are exposed to credit loss in the event of nonperformance by our counter parties to the interest rate swap agreements. We do not anticipate nonperformance by these financial institutions, and no material loss would be expected from the nonperformance of these financial institutions.

Although we repaid the term indebtedness under the existing senior secured credit facility, we did not cancel the related interest rate swap agreements. We continue to maintain these agreements. The changes in the fair values of the interest rate swaps as well as the amortization of the amounts recorded in other comprehensive income will be recognized as components of interest expense subsequent to the payoff of the floating rate debt.

OUTLOOK

Based on our current level of operations, and anticipated revenue growth, we believe that cash generated from operations and amounts available under our credit facility will be adequate to meet our anticipated debt service requirements, capital expenditures and working capital needs for the foreseeable future. We cannot assure you, however, that our business will generate sufficient cash flow from operations, that our anticipated revenue growth will be realized, or that future borrowings will be available under our credit facility or otherwise will be available to enable us to service our indebtedness, including the credit facility and the notes, to retire or redeem the notes when required or to make anticipated capital expenditures. In addition, if we consummate significant acquisitions in the future, our cash requirements may increase significantly. We may need to refinance all or a portion of our debt on or before maturity. Our future operating performance and our ability to service or refinance our debt will be subject to future economic conditions and to financial, business and other factors, many of which are beyond our control.

PENN NATIONAL GAMING, INC. AND SUBSIDIARIES
CONSOLIDATED BALANCE SHEETS

DECEMBER 31,	2000	2001
(In thousands, except share and per share data)		
Assets		
Current assets		
Cash and cash equivalents	$ 23,287	$ 38,378
Receivables	10,341	19,367
Prepaid expenses and other current assets	5,312	7,751
Prepaid income taxes	1,905	–
Deferred income taxes	–	4,610
Total current assets	40,845	70,106
Property, plant and equipment, at cost		
Land and improvements	81,177	82,981
Building and improvements	142,753	226,478
Furniture, fixtures and equipment	79,606	104,215
Transportation equipment	1,015	1,175
Leasehold improvements	11,704	11,795
Construction in progress	3,643	21,338
	319,898	447,982
Less accumulated depreciation and amortization	31,582	58,063
	288,316	389,919
Other assets		
Investment in and advances to unconsolidated affiliates	14,584	14,187
Cash in escrow	5,107	500
Excess of cost over fair market value of net assets acquired net of accumulated amortization of $3,858 and $7,371, respectively	78,161	160,210
Management service contract (net of accumulated amortization of $1,695)	–	24,050
Deferred financing costs, net	9,585	14,090
Miscellaneous	3,302	6,315
Total other assets	110,739	219,352
	$439,900	$679,377

See accompanying notes to consolidated financial statements.

DECEMBER 31,	2000	2001
(In thousands, except share and per share data)		
Liabilities and Shareholders' Equity		
Current liabilities		
Current maturities of long-term debt	$11,390	$15,141
Accounts payable	18,436	18,975
Accrued expenses	6,913	19,623
Accrued interest	1,289	14,263
Accrued salaries and wages	3,957	13,533
Taxes, other than income taxes	2,816	5,272
Income taxes	–	180
Other current liabilities	4,489	5,108
Total current liabilities	49,290	92,095
Long-term liabilities		
Long-term debt, net of current maturities	297,909	443,768
Deferred income taxes	13,480	40,249
Total long-term liabilities	311,389	484,017
Commitments and contingencies		
Shareholders' equity		
Preferred stock, $.01 par value, authorized 1,000,000 shares; no shares issued	–	–
Common stock, $.01 par value, authorized 200,000,000 shares; shares issued 15,459,175 and 15,933,425, respectively	155	160
Treasury stock, at cost 424,700 shares	(2,379)	(2,379)
Additional paid-in capital	39,482	43,605
Retained earnings	41,963	65,721
Accumulated other comprehensive loss	–	(3,842)
Total shareholders' equity	79,221	103,265
	$439,900	$679,377

See accompanying notes to consolidated financial statements.

PENN NATIONAL GAMING, INC. AND SUBSIDIARIES
CONSOLIDATED STATEMENTS OF INCOME

YEAR ENDED DECEMBER 31,	1999	2000	2001
(In thousands, except per share data)			
Revenues			
Gaming	$ 55,415	$159,589	$366,166
Racing	102,827	113,230	112,243
Management service fee	–	–	8,297
Other revenue	12,118	18,982	32,686
Total revenues	170,360	291,801	519,392
Operating expenses			
Gaming	34,951	94,087	202,198
Racing	68,808	77,063	78,509
Other	11,173	18,776	33,852
General and administrative	30,030	44,716	95,028
Depreciation and amortization	7,733	12,039	32,093
Total operating expenses	$152,695	$246,681	$441,680
Income from operations	17,665	45,120	77,712
Other income (expense)			
Interest expense	(9,613)	(20,644)	(46,097)
Interest income	1,368	1,875	3,016
Earnings from joint venture	1,098	2,322	2,531
Other	(8)	39	(796)
Total other expense	(7,155)	(16,408)	(41,346)
Income before income taxes and extraordinary item	10,510	28,712	36,366
Taxes on income	3,777	10,137	12,608
Income before extraordinary item	6,733	18,575	23,758
Extraordinary item, loss on early extinguishment of debt, net of income taxes of $4,615	–	(6,583)	–
Net income	$ 6,733	$ 11,992	$ 23,758
Per share data			
Basic			
Income before extraordinary item	$.45	$1.24	$1.55
Extraordinary item	–	(.44)	–
Net income	$.45	$.80	$1.55
Diluted			
Income before extraordinary item	$.44	$1.20	$1.49
Extraordinary item	–	(.42)	–
Net income	$.44	$ .78	$1.49
Weighted shares outstanding			
Basic	14,837	14,968	15,327
Diluted	15,196	15,443	15,918

See accompanying notes to consolidated financial statements.

PENN NATIONAL GAMING, INC. AND SUBSIDIARIES
CONSOLIDATED STATEMENTS OF SHAREHOLDERS' EQUITY AND COMPREHENSIVE INCOME

	COMMON STOCK SHARES	COMMON STOCK AMOUNT	TREASURY STOCK	ADDITIONAL PAID-IN CAPITAL	RETAINED EARNINGS	ACCUMULATED OTHER COMPREHENSIVE LOSS	TOTAL	COMPREHENSIVE INCOME
(In thousands, except share data)								
Balance, December 31, 1998	15,164,080	$152	$(2,379)	$38,025	$23,238	$ –	$ 59,036	$ –
Exercise of stock options and warrants	150,095	1	–	502	–	–	503	–
Net income for the year	–	–	–	–	6,733	–	6,733	–
Balance, December 31, 1999	15,314,175	153	(2,379)	38,527	29,971	–	66,272	–
Exercise of stock options including tax benefit of $265	145,000	2	–	955	–	–	957	–
Net income for the year	–	–	–	–	11,992	–	11,992	–
Balance, December 31, 2000	15,459,175	155	(2,379)	39,482	41,963	–	79,221	–
Exercise of stock options including tax benefit of $1,196	474,250	5	–	4,123	–	–	4,128	–
Fair market value of swap agreement, net of income tax benefit of $2,043	–	–	–	–	–	(3,794)	(3,794)	(3,794)
Foreign currency translation adjustment	–	–	–	–	–	(48)	(48)	(48)
Net income for the year	–	–	–	–	23,758	–	23,758	23,758
Balance, December 31, 2001	15,933,425	$160	$(2,379)	$43,605	$65,721	$(3,842)	$103,265	$19,916

See accompanying notes to consolidated financial statements.

PENN NATIONAL GAMING, INC. AND SUBSIDIARIES
CONSOLIDATED STATEMENTS OF CASH FLOWS

YEAR ENDED DECEMBER 31,	1999	2000	2001
(In thousands)			
Cash flows from operating activities			
Net income	$ 6,733	$11,992	$23,758
Adjustments to reconcile net income to net cash provided by operating activities			
Depreciation and amortization	7,733	12,039	32,093
Amortization of deferred financing costs charged to interest expense	946	1,555	2,444
Loss on sale of fixed assets	–	–	809
Earnings from joint venture	(1,098)	(2,322)	(2,531)
Extraordinary loss on early extinguishment of debt, before income tax benefit	–	11,198	–
Deferred income taxes	910	3,278	6,959
Tax benefit from stock options exercised	–	265	1,196
Decrease (increase), net of businesses acquired, in			
Receivables	(939)	(5,562)	2,226
Prepaid expenses and other current assets	338	(3,663)	(546)
Prepaid income taxes	(229)	(817)	1,905
Miscellaneous other assets	(202)	(2,025)	(1,149)
Increase (decrease), net of businesses acquired, in			
Accounts payable	3,993	8,226	(2,473)
Accrued expenses	1,744	2,385	(4,663)
Accrued interest	(35)	856	12,974
Accrued salaries and wages	346	2,859	9,576
Taxes, other than income taxes	988	1,325	2,456
Income taxes payable	–	–	180
Other current liabilities	1,233	224	619
Net cash provided by operating activities	22,461	41,813	85,833

See accompanying notes to consolidated financial statements.

YEAR ENDED DECEMBER 31,	1999	2000	2001
(In thousands)			
Cash flows from investing activities			
Expenditures for property, plant and equipment	(13,243)	(27,295)	(41,511)
Proceeds from sale of property and equipment	–	151	299
(Investment in and advances to) and distributions from joint venture	(11,764)	511	2,928
Acquisition of businesses, net of cash acquired	251	(203,030)	(182,658)
(Increase) decrease in cash in escrow	(5,000)	(107)	4,607
Net cash used in investing activities	(29,756)	(229,770)	(216,335)
Cash flows from financing activities			
Proceeds from exercise of options and warrants	503	692	2,932
Proceeds from long-term debt	24,350	323,395	211,000
Principal payments on long-term debt	(11,393)	(105,185)	(61,389)
Increase in unamortized financing cost	(3,557)	(10,407)	(6,950)
Payment of tender fees on senior notes	–	(6,685)	-
Net cash provided by financing activities	9,903	201,810	145,593
Net increase in cash and cash equivalents	2,608	13,853	15,091
Cash and cash equivalents at beginning of year	6,826	9,434	23,287
Cash and cash equivalents at end of year	$ 9,434	$ 23,287	$ 38,378

See accompanying notes to consolidated financial statements.

1. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

BUSINESS
Penn National Gaming, Inc. (the "Company") owns and operates the Charles Town Entertainment Complex in Charles Town, West Virginia, which features gaming machines and live thoroughbred racing; two Mississippi casinos: the Casino Magic Bay St. Louis casino, hotel, golf resort and marina in Bay St. Louis, and the Boomtown Biloxi casino in Biloxi; Louisiana Casino Cruises, Inc. ("LCCI") which owns and operates the Casino Rouge, a riverboat gaming facility in Baton Rouge, Louisiana; CRC Holdings, Inc. ("CRC") which has a management contract for the operation of Casino Rama, a casino located approximately ninety miles north of Toronto, Canada on the Chippewas of Mnjikaning First Nation land and two racetracks and eleven off-track wagering (OTW) facilities located in Pennsylvania. The Company also owns a 50% interest in Pennwood Racing, Inc., a joint venture that operates Freehold Raceway in New Jersey.

BASIS OF PRESENTATION
The consolidated financial statements include the accounts of the Company and its wholly owned subsidiaries. All significant intercompany accounts and transactions have been eliminated in consolidation.

REVENUES
In accordance with common industry practice, casino revenues are the net of gaming wins less losses. Revenues exclude the retail value of complimentary rooms, food and beverage furnished gratuitously to customers. The estimated cost of providing these promotional allowances (which are netted against gross revenue) during the years ended December 31, 2000 and 2001 was $8,806,000 and $24,579,000, respectively. These complimentary items were not significant to the Company's total revenues prior to 2000 when the Company operated primarily as a pari-mutuel company.

Racing revenues include the Company's share of pari-mutuel wagering on live races after payment of amounts returned as winning wagers, and the Company's share of wagering from import and export simulcasting, as well as its share of wagering from its OTWs.

MANAGEMENT SERVICE FEE
Revenues from the management service contract for Casino Rama (see Note 2) are based upon contracted terms and are recognized when the services are performed.

DEPRECIATION AND AMORTIZATION
Depreciation of property, plant and equipment and amortization of leasehold improvements are computed by the straight-line method at rates adequate to allocate the cost of applicable assets over their estimated useful lives ranging from three to forty years. The excess of cost over fair value of net assets acquired is being amortized on the straight-line method over forty years.

Amortization of the management service contract for Casino Rama is computed by the straight-line method through July, 2011, the expiration date of the agreement.

The Company reviews the carrying values of its long-lived and identifiable intangible assets for possible impairment whenever events or changes in circumstances indicate that the carrying amount of the assets may not be recoverable based on undiscounted estimated future operating cash flows. As of December 31, 2001, the Company has determined that no impairment has occurred.

INCOME TAXES
The Company recognizes deferred tax assets and liabilities for the expected future tax consequences of events that have been recognized in the Company's financial statements or tax returns. Under this method, deferred tax assets and liabilities are determined based on the difference between the financial statement carrying amounts and the tax bases of assets and liabilities using enacted tax rates in effect in the years in which the differences are expected to reverse.

CASH AND CASH EQUIVALENTS
The Company considers all cash balances and highly liquid investments with original maturities of three months or less to be cash equivalents.

NET INCOME PER COMMON SHARE
Basic net income per share includes no dilution and is calculated by dividing net income by the weighted average number of common shares outstanding for the period. Dilutive net income per share reflects the potential dilution of net income per share that could result upon the exercise of outstanding stock options to purchase the Company's common stock (using the treasury stock method).

Shares of common stock from dilutive stock options included in the denomination for the calculation of diluted earnings per share were 359,000, 475,000 and 591,000 shares at December 1999, 2000 and 2001, respectively.

Options to purchase 590,000, 590,500 and 68,000 shares of common stock, with average exercise prices per share of $16.74, $17.14 and $19.61 were outstanding at December 31, 1999, 2000 and 2001, respectively. These options were not included in the computations of diluted earnings per common share for the respective years because the exercise prices of the options were greater than the average market prices of the common stock during the respective periods. These options expire at various times between October 2002 and January 2011.

DEFERRED FINANCING COSTS
Deferred financing costs that are incurred by the Company in connection with the issuance of debt are deferred and amortized to interest expense over the life of the underlying indebtedness using the interest method adjusted to reflect any early repayments.

CONCENTRATION OF CREDIT RISK
Financial instruments that potentially subject the Company to credit risk consist of cash equivalents and accounts receivable.

The Company's policy is to limit the amount of credit exposure to any one financial institution and place investments with financial institutions evaluated as being creditworthy, or in short-term money market and tax-free bond funds which are exposed to minimal interest rate and credit risk. At December 31, 2001, and during the year then ended the Company had bank deposits and overnight repurchase agreements which, at times, exceeded federally insured limits.

Concentration of credit risk, with respect to receivables, is limited through the Company's credit evaluation process. The Company does not require collateral on its receivables. The Company's receivables consist principally of amounts due from other racetracks and their OTWs and $9.3 million due from Casino Rama for management service fees of $1.1 million and reimbursement of $8.2 million of expenses to be paid on behalf of Casino Rama as of December 31, 2001. The payable on behalf of Casino Rama is included in accrued salaries and wages in the accompanying consolidated balance sheet as of December 31, 2001. Historically, the Company has not incurred any significant credit-related losses.

FAIR VALUE OF FINANCIAL INSTRUMENTS
The following methods and assumptions are used to estimate the fair value of each class of financial instruments for which it is practical to estimate:

> Cash and Cash Equivalents: The carrying amount approximates the fair value due to the short maturity of the cash equivalents.
>
> Long-term Debt: The fair value of the Company's long-term debt is estimated based on the quoted market prices for the same or similar issues or on the current rates offered to the Company for debt of the same remaining maturities. The carrying amount approximates fair value since the Company's interest rates approximate current interest rates.

USE OF ESTIMATES
The preparation of financial statements in conformity with generally accepted accounting principles requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities at the date of the financial statements, and the reported amounts of revenue and expenses for the reporting periods. Actual results could differ from those estimates.

INTEREST RATE SWAPS

The Company has a policy aimed at managing interest rate risk associated with its current and anticipated future borrowings. This policy enables the Company to use any combination of interest rate swaps, futures, options, caps and similar instruments. To the extent the Company employs such financial instruments pursuant to this policy, they are accounted for as hedging instruments. In order to qualify for hedge accounting, the underlying hedged item must expose the Company to risks associated with market fluctuations and the financial instrument used must be designated as a hedge and must reduce the Company's exposure to the market in fluctuations throughout the hedge period. If these criteria are not met, a change in the market value of the financial instrument is recognized as a gain or loss in the period of change. Otherwise, gains and losses are not recognized except to the extent that the financial instrument is disposed of prior to maturity. Net interest paid or received pursuant to the financial instrument is included as interest expense in the period.

Financial Accounting Standards Board ("FASB") Statement No. 133 (SFAS 133), "Accounting for Derivative Instruments and Hedging Activities," and Statement No. 138 (SFAS 138), "Accounting for Derivative Instruments and Hedging Activities - an amendment of SFAS 133," were effective for fiscal years beginning after June 15, 2000 - fiscal year 2001 for the Company. The Company has conducted evaluations of hedging policies and strategies for existing and anticipated future derivative transactions. Adoption of these statements as of January 1, 2001 did not have a significant effect on the Company's financial statements. Recognition of derivative assets or liabilities on the balance sheet with market value adjustments recognized in other comprehensive income was not material as of January 1, 2001.

RECENT ACCOUNTING STANDARDS

In June 2001, the Financial Accounting Standards Board finalized FASB Statements No. 141, *Business Combinations* (SFAS 141) and No. 142, *Goodwill and Other Intangibles Assets* (SFAS 142). SFAS 141 requires the use of the purchase method accounting and prohibits the use of pooling-of-interests method of accounting for business combinations initiated after June 30, 2001. SFAS 141 also requires that the Company recognize acquired intangible assets apart from goodwill if the acquired intangible assets meet certain criteria. SFAS 141 applies to all business combinations initiated after June 30, 2001 and for purchase business combinations completed on or after July 1, 2001. It also requires, upon adoption of SFAS 142 that the Company reclassify the carrying amounts of intangible assets and goodwill based on certain criteria in SFAS 141.

SFAS 142 requires, among other things, that companies no longer amortize goodwill, but instead test goodwill for impairment at least annually. In addition, SFAS 142 requires that the Company identify reporting units for the purpose of assessing potential future impairments of goodwill, reassess the useful lives of the other existing recognized intangible assets, and cease amortization of intangible assets with an indefinite useful life. Any intangible asset with an indefinite useful life should be tested for impairment in accordance with the guidance in SFAS 142. SFAS 142 is required to be applied in fiscal years beginning after December 15, 2001 to all goodwill and other intangible assets recognized at that date, regardless of when those assets were initially recognized. SFAS 142 requires the Company to complete a transitional goodwill impairment test six months from the date of adoption. The Company is also required to reassess the useful lives of the other intangible assets within the first interim quarter after adoption of SFAS 142.

The Company's previous business combinations were accounted for using the purchase method. As of December 31, 2001, net carrying amount of goodwill is $160.2 million and other intangible assets (management service contract for Casino Rama) is $24.1 million. Amortization expense or goodwill and other intangible assets for the year ended December 31, 2001 was $3.5 million and $1.7 million, respectively. Currently, the Company is assessing but has not yet determined how the adoption of SFAS 142 will impact its financial position and results of operations.

In October 2001, the FASB issued SFAS No. 144, "Accounting for the Impairment or Disposal of Long-Lived Assets" ("SFAS 144"). This statement addresses financial accounting and reporting for the impairment or disposal of long-lived assets. This statement supersedes SFAS Statement No. 121, "Accounting for the Impairment of Long-Lived Assets and for Long-Lived Assets to Be Disposed Of," and the accounting and reporting provisions of APB Opinion No. 30, "Reporting the Results of Operations-Reporting the Effects of Disposal of a Segment of a Business, and Extraordinary, Unusual and Infrequently Occurring Events and Transactions." This statement also amends ARB No. 51 "Consolidated Financial Statements," to eliminate the exception to consolidation for a subsidiary for which control is likely to be temporary. This statement requires that one accounting model be used for long-lived assets to be disposed of by sale, whether previously held and used or newly acquired. This statement also broadens the presentation of discontinued operations to include more disposal transactions. SFAS 144 is effective for fiscal years beginning after December 15, 2001 and interim periods within those fiscal years. Currently, the Company is assessing but has not determined how the adoption of SFAS 144 will impact its financial position and results of operations.

RECLASSIFICATION

Certain prior years amounts have been reclassified to conform to the current year presentation.

2. ACQUISITIONS

CRC

On April 27, 2001, the Company completed its acquisitions of (i) CRC Holdings, Inc. ("CRC") from the shareholders of CRC and (ii) the minority interest in Louisiana Casino Cruises, Inc. ("LCCI") not owned by CRC from certain shareholders (together, the "CRC Acquisition"). The CRC Acquisition was accomplished pursuant to the terms of Agreement and Plan of Merger among CRC Holdings, Inc., Penn National Gaming, Inc., Casino Holdings, Inc. and certain shareholders of CRC Holdings, Inc., dated as of July 31, 2000 (the "Merger Agreement"), and a Stock Purchase Agreement by and among Penn National Gaming, Inc. and certain shareholders of LCCI, dated as of July 31, 2000. Under the Merger Agreement, CRC merged with Casino Holdings, Inc., a wholly owned subsidiary of the Company (the "Merger"). The aggregate consideration paid by the Company for the CRC Acquisition was approximately $182 million, including the repayment of existing debt of CRC and its subsidiaries. The purchase price of the CRC Acquisition was funded by the proceeds of the Company's offering of senior subordinated notes, which was completed in March 2001.

The assets acquired pursuant to the Merger and CRC Acquisition consist primarily of the Casino Rouge riverboat gaming facility in Baton Rouge, Louisiana, and a management contract for Casino Rama, a gaming facility located in Orillia, Canada.

The management service contract expires July 31, 2011. CHC Casinos Canada Limited ("CHC"), a wholly owned subsidiary of the Company, operates Casino Rama in the province of Ontario. The Company derives all of its management service fee revenue from this agreement. As of the date of the acquisition, the fair value of the management service contract was $25.7 million.

MISSISSIPPI

On August 8, 2000, the Company completed its acquisition of all of the assets of the Casino Magic hotel, casino, golf resort, recreational vehicle park and marina in Bay St. Louis, Mississippi and the Boomtown Biloxi casino in Biloxi, Mississippi (the "Mississippi Acquisitions"), from Pinnacle Entertainment, Inc. (formerly Hollywood Park, Inc.). The Mississippi Acquisitions were accomplished pursuant to the terms of two asset purchase agreements, each dated December 10, 1999, for an aggregate of $195 million. In addition to acquiring all of the operating assets and related operations of the Casino Magic Bay St. Louis and Boomtown Biloxi properties, the Company entered into a licensing agreement to use the Boomtown and Casino Magic names and marks at the properties acquired.

CHARLES TOWN MINORITY INTEREST

On March 15, 2000, the Company purchased from the BDC Group ("BDC"), its joint venture partner in West Virginia, BDC's 11% interest in PNGI Charles Town Gaming Limited Liability Company, which owns and operates the Charles Town Entertainment Complex, for $6.0 million in cash. As a result of the purchase, PNGI Charles Town Gaming Limited Liability Company is now a 100% owned subsidiary of the Company.

ACQUISITION ACCOUNTING

The Company accounted for its acquisitions as purchases in accordance with Accounting Principles Board No. 16. The results of operations of the acquisitions are included in the consolidated financial statements from their respective dates of acquisition through December 31, 2001.

The excess of the purchase price paid over the fair market value of the net assets acquired, or goodwill, is currently amortized on a straight-line basis over 40 years. During 2001, as a result of the CRC Acquisition, the Company recorded goodwill totaling $85.5 million. Goodwill recorded in 2000 from the Mississippi and Charles Town minority interest acquisitions was $62.1 million and $1.5 million, respectively.

UNAUDITED PROFORMA FINANCIAL INFORMATION

Unaudited pro forma financial information for the years ended December 31, 2000 and 2001, as though the Mississippi and CRC Acquisitions had occurred on January 1, 2000, is as follows:

YEAR ENDED DECEMBER 31,	2000	2001
(In thousands, except per share data)		
Revenues	$493,776	$555,366
Income before extraordinary item	$21,617	$26,956
Extraordinary item, net of income tax benefit	(6,583)	–
Net income	$15,034	$26,956
Net income per common share		
Basic	$1.00	$1.76
Diluted	$ .97	$1.69
Weighted shares outstanding		
Basic	14,968	15,327
Diluted	15,443	15,918

3. LONG-TERM DEBT

Long-term debt is as follows:

DECEMBER 31,	2000	2001
(In thousands)		
$350 million senior secured credit facility. This credit facility is secured by substantially all of the assets of the Company.	$309,250	$258,875
$200 million 11 1/8 % senior subordinated notes. These notes are general unsecured obligations of the Company.	–	200,000
Other notes payable	49	34
	309,299	458,909
Less current maturities	11,390	15,141
	$297,909	$443,768

SENIOR SECURED CREDIT FACILITY

On August 8, 2000, the Company entered into a $350 million senior secured credit facility with Lehman Brothers, Inc. and CIBC World Markets Corp. as co-arrangers, among others. The proceeds of the credit facility were used to finance the Mississippi Acquisitions, to pay off the Company's existing long-term debt and for working capital purposes. The credit facility provides for a $75 million revolving credit facility maturing on August 8, 2005, a $75 million Tranche A term loan maturing on August 8, 2005 and a $200 million Tranche B term loan maturing on August 8, 2006. The Company is required to repay the principal balance of the debt based upon a payment as stipulated in the loan agreement.

At the Company's option, the revolving credit facility and the Tranche A term loan may bear interest at (1) the highest of 1/2 of 1% in excess of the federal funds effective rate or the rate that the bank group announces from time to time as its prime lending rate plus an applicable margin of up to 2.25%, or (2) a rate tied to a eurodollar rate plus an applicable margin up to 3.25%. At the Company's option, the Tranche B term loan may bear interest at (1) the highest of 1/2 of 1% in excess of the federal funds effective rate or the rate that the bank group announces from time to time as its prime lending rate plus an applicable margin of up to 3.25%, or (2) a rate tied to a eurodollar rate plus an applicable margin up to 4.00%.

The credit facility provides for certain covenants, including those of a financial nature. Substantially all of the Company's assets are pledged as collateral under the credit agreement.

The weighted average effective interest rate at December 31, 2001 was 8.40%.

The outstanding amounts under the credit facility as of December 31, 2001 (in thousands) are as follows:

Revolving credit facility	$ -
Tranche A	61,875
Tranche B	197,000
Total	$258,875

As a result of the refinancing, the Company charged to operations deferred financing costs of $4.5 million related to the repayment of existing outstanding debt. In addition, the Company paid a tender premium of $6.7 million. The total, $11.2 million, has been reflected as an extraordinary item, net of an income tax benefit of $4.6 million in the consolidated statement of income for the year ended December 31, 2000.

SENIOR SUBORDINATED NOTES

On March 12, 2001, the Company completed an offering of $200 million of its 11⅛% Senior Subordinated Notes due 2008. Interest on the notes is payable on March 1 and September 1 of each year, beginning September 1, 2001. These notes mature on March 1, 2008.

The Company may redeem all or part of the notes on or after March 1, 2005 at certain specified redemption prices. Prior to March 1, 2004, the Company may redeem up to 35% of the notes from proceeds of certain sales of its equity securities. The notes also are subject to redemption requirements imposed by state and local gaming laws and regulations.

The notes are general unsecured obligations and are guaranteed on a senior subordinated basis by all of the Company's current and future wholly owned domestic subsidiaries. The notes rank equally with the Company's future senior subordinated debt and junior to its senior debt, including debt under the Company's senior credit facility. In addition, the notes will be effectively junior to any indebtedness of our non-U.S. or unrestricted subsidiaries, none of which guarantee the notes.

The notes and guarantees were originally issued in a private placement pursuant to an exemption from the registration requirements of the Securities Act of 1933, as amended (the "Securities Act"). On July 30, 2001, the Company completed an offer to exchange the notes and guarantees for notes and guarantees registered under the Securities Act having substantially identical terms.

The proceeds from these notes were used to finance the CRC Acquisition that was completed on April 27, 2001.

The following is a schedule of future minimum repayments of long-term debt as of December 31, 2001:

DECEMBER 31, *(In thousands)*	
2002	$ 15,141
2003	18,893
2004	22,625
2005	107,250
2006	95,000
Thereafter	200,000
Total minimum payments	458,909

At December 31, 2001, the Company was contingently obligated under letters of credit issued pursuant to the senior secured credit facility with face amounts aggregating $3.6 million.

The Company currently uses interest rate swaps to assist in managing interest incurred on its long-term debt. The difference between amounts received and amounts paid under such agreements, as well as any costs or fees, is recorded as a reduction of, or addition to, interest expense as incurred over the life of the swap or similar financial instrument. On December 20, 2000, the Company entered into a forward interest rate swap with a notional amount of $100 million, which has an effective date of December 22, 2000 and a termination date of December 22, 2003. Under this agreement, the Company pays a fixed rate of 5.835% against a variable interest rate based on the 90-day LIBOR rate. On August 3, 2001, the Company entered into a forward interest rate swap with a notional amount of $36 million, which has an effective date of August 7, 2001 and a termination date of June 30, 2004. Under this agreement, the Company pays a fixed rate of 4.8125% against a variable interest rate based on the 90-day LIBOR rate. At December 31, 2001, the 90-day LIBOR rate was 1.92%. The Company entered into these interest rate swap agreements to reduce the impact of future variable interest payments related to the Company's senior secured credit facility. The Company accounts for the interest rate swap agreements as cash flow hedges. The changes in the fair values of the interest rate swaps are recorded as adjustments to accrued interest in the accompanying consolidated balance sheet with the offset recorded in accumulated other comprehensive loss, which as of December 31, 2001 amounted to $3.8 million, net of an income tax benefit of $2.0 million. Any hedge ineffectiveness was not material for the year ended December 31, 2001. Amounts recorded in accumulated other comprehensive income will be amortized as an adjustment to interest expense over the term of the related derivative. The Company estimates $1.8 million of net derivative losses included in other comprehensive income will be reclassified into interest expense within the next twelve months.

4. COMMITMENTS AND CONTINGENCIES

LITIGATION

In 1997 the Company acquired the Charles Town Races property in Charles Town, West Virginia, by exercising an option held by Showboat Development Company, now a wholly owned subsidiary of Harrah's Entertainment, Inc. In return for assigning the option, Showboat retained the right to operate a casino at the Charles Town Races property in return for a management fee, to be negotiated at the time of exercise, based on reasonable rates for similar properties. The express terms of the Showboat option do not specify what activities at Charles Town Races would constitute operation of a casino. The Company believes that its installation and operation of video lottery terminals linked to the West Virginia Lottery at the Charles Town Races facility does not constitute the operation of a casino under the Showboat option or under West Virginia law and therefore does not trigger Showboat's right to exercise the Showboat option. The rights under the Showboat option extended until November 2001.

On August 20, 2001, the Company was served with a lawsuit brought by Showboat Development Company against the Company and certain other parties related to the Charles Town Entertainment Complex. The suit alleges, among other things, that the Company's operation of coin-out video lottery terminals at the Charles Town facility constitutes the operation of a casino, thereby triggering Showboat's option. The suit also alleges that the Company's March 2000 acquisition of the 11% minority interest in Charles Town Races from BDC Group, the Company's former joint venture partner, was made in violation of a right of first refusal that Showboat holds from BDC covering the sale of any interest in any casino at Charles Town Races. The Company filed in federal district court in Nevada a motion to dismiss this action for lack of personal jurisdiction. And, in the alternative, a motion to transfer the case to the state of West Virginia was filed.

On January 25, 2002, the United States Court for the District of Nevada granted the Company's motion to dismiss. (See Note 12 – Subsequent Events.)

In July 2001, a lawsuit was filed against the Company by certain surveillance employees at the Charles Town facility claiming that the Company's surveillance of those employees during working hours was improper. The lawsuit claims damages of $7.0 million and punitive damages of $15.0 million. The Company currently is conducting discovery in the case but, at this time, it believes that all of the claims of the employees are without merit. On February 12, 2002, the Company filed a motion for summary judgment that is pending before the court. The Company intends to vigorously defend itself against this action and does not believe that this action will have a material adverse effect on the Company's financial condition or results of operations.

In January 2002, an employee at the Charles Town facility initiated a suit against the Company alleging invasion of privacy. The employee claims in the suit that she was subjected to an involuntary strip search by other Charles Town employees as part of a theft investigation and is seeking punitive damages. The lawsuit claims damages of $0.5 million and punitive damages of $3.5 million. The Company believes that it has meritorious defenses and intends to vigorously defend itself against this suit.

The Company also is a party to certain other litigation but does not believe it will have a material adverse effect on the Company's financial condition or results of operations if any of these legal proceedings were adversely adjudicated or settled. Furthermore, the nature of the Company's business subjects it to the risk of lawsuits filed by customers and others in the ordinary course. In general, litigation can be expensive and time consuming to defend and could result in settlements or damages that could significantly impact results of operations or financial condition.

OPERATING LEASES

The Company is liable under numerous operating leases for automobiles, other equipment and buildings, which expire through 2010. Total rental expense under these agreements was $1.3 million, $2.1 million and $4.0 million for the years ended December 31, 1999, 2000, and 2001, respectively.

The future lease commitments relating to noncancelable operating leases as of December 31, 2001 are as follows:

(In thousands)	
2002	$3,530
2003	3,325
2004	2,149
2005	1,163
2006	815
Thereafter	947
	$11,929

In addition, the Company leases land for use by Boomtown Biloxi. The lease term is 99 years and is cancelable upon one year's notice. The lease called for an initial deposit by the Company of $2.0 million and for annual base lease rent payments of $2.0 million and percentage rent equal to 5.0% of adjusted gaming win (as defined in the lease) over $25.0 million and 6.0% of the amount by which the adjusted gaming win exceeds $50.0 million. During the period from August 8, 2000 to December 31, 2000 and for the year ended December 31, 2001, the Company paid lease rent under this agreement of $1.3 million and $3.6 million respectively.

EMPLOYEE BENEFIT PLANS

The Company has profit sharing plans under the provisions of Section 401(k) of the Internal Revenue Code that cover all eligible employees who are not members of a bargaining unit. The plans enable employees choosing to participate to defer a portion of their salary in a retirement fund to be administered by the Company. The Company's contributions to the plans are set at 50% of employees' elective salary deferrals up to a maximum of 6% of employee compensation. The Company also has a defined contribution plan, the Charles Town Races Future Service Retirement Plan, covering substantially all of its union employees at the Charles Town Entertainment Complex. The Company makes monthly contributions equal to the amount accrued for retirement expense, which is calculated as .25% of the daily mutual handle and .5% of the net video lottery revenues. Total contributions to the plans for the years ended December 31, 1999, 2000 and 2001 were $0.4 million, $1.1 million and $1.8 million, respectively.

The Company maintains a non-qualified defined contribution deferred compensation plan that covers most management and other highly compensated employees. This plan was effective March 1, 2001. The plan allows the participants to defer, on a pre-tax basis, a portion of their base annual salary and bonus and earn tax-deferred earnings on these deferrals. The plan also provides for matching Company contributions that vest over a seven-year period. The Company has established a Trust and transfers to the Trust, on an annual basis, an amount necessary to provide on a present value basis for its respective future liabilities with respect to participant deferral and Company contribution amounts. Plan contributions, net of forfeitures, for the initial period ended December 31, 2001 amounted to $0.5 million.

AGREEMENTS WITH HORSEMEN AND PARI-MUTUEL CLERKS

The Company has agreements with the horsemen at each of the racetracks. The continuation of these agreements is required to allow the Company to conduct live racing and export and import simulcasting. In addition, the simulcasting agreements are subject to the horsemen's approval.

On March 23, 1999, the Company entered into a new four-year, nine-month purse agreement with the Horsemen's Benevolent and Protection Association, which represents the horsemen at the Company's Penn National Race Course facility in Grantville, Pennsylvania. The agreement ended an action by the horsemen, which began on February 16, 1999 and caused the Company to close Penn National Race Course and its six affiliated OTWs. As a result of the action the Company incurred a nonrecurring $1.3 million expense, primarily related to costs incurred to maintain the closed facilities inclusive of employee salaries and rents, for Horsemen's Action Expense. The initial term of the agreement ends on January 1, 2004 and automatically renews for another two-year period, without change, unless notice is given by either party at least ninety days prior to the end of the initial term.

On December 17, 1999, the Company entered into a new three-year purse agreement with the Pennsylvania Harness Horsemen's Association, Inc., which represents the owners, trainers, and drivers at the Company's The Downs Racing, Inc. facility in Wilkes-Barre, Pennsylvania. The contract term began on January 16, 2000 and ends on January 15, 2003. The Company also has an agreement with the Charles Town Horsemen that expires on December 31, 2002.

In addition to the horsemen agreements, in order to operate gaming machines in West Virginia, the Company is required to enter into written agreements regarding the proceeds of the gaming machines at the Charles Town Entertainment Complex with the parti-mutuel clerks at Charles Town. The agreement with the pari-mutuel clerks at Charles Town expires on December 31, 2004.

NEW JERSEY JOINT VENTURE

On January 28, 1999, the Company, along with its Joint Venture partner, Greenwood New Jersey, Inc. purchased certain assets and assumed certain liabilities of Freehold Racing Association, Garden State Racetrack and related entities, in a transaction accounted for as a purchase (the "New Jersey Acquisition").

Upon completion of the New Jersey Acquisition, the Company entered into a lease agreement for real property and equipment at Garden State Park (the leased premises). In December 2000, the leased premises were sold. In accordance with the lease, the agreement terminated 180 days after the closing of the sale. As a result, the Joint Venture's operations at Garden State Park ceased during May 2001.

The purchase price for the New Jersey Acquisition was approximately $46.0 million. The Company made an $11.3 million loan to the Joint Venture and an equity investment of $0.3 million. The loan is evidenced by a subordinated secured note which has been included in investment in and advances to unconsolidated affiliates in the consolidated financial statements. The note bears interest at prime plus 2.25% or a minimum of 10% (as of December 31, 2001 the interest rate was 10%). The Company has recorded interest income in the accompanying consolidated financial statements of $1.0 million, $1.3 million, and $1.2 million for the years ended December 31, 1999, 2000 and 2001, respectively.

In conjunction with the closing, the Company entered into a Debt Service Maintenance Agreement with a bank to guarantee 50% of a $23.0 million term loan to the Joint Venture. As of December 31, 2001, our obligation under our guarantee of the term loan was limited to approximately $10.4 million. The Company's investment in the Joint Venture is accounted for under the equity method. The original investment was recorded at cost and has been adjusted by the Company's share of income of the Joint Venture and distributions received. The Company's 50% share of the income of the Joint Venture is included in other income (expense) in the accompanying consolidated statements of income.

5. INCOME TAXES

Deferred tax assets and liabilities are comprised of the following:

DECEMBER 31,	2000	2001
(In thousands)		
Deferred tax assets		
Accrued expenses	$ –	$ 3,625
State net operating losses	2,027	2,303
Other comprehensive income	–	2,043
Gross deferred tax assets	$ 2,027	$ 7,971
Deferred tax liabilities		
Property, plant and equipment	($15,507)	($43,610)
Net deferred taxes	($13,480)	($35,639)
Reflected on consolidated balance sheets:		
Current deferred tax assets, net	$ –	$ 4,610
Noncurrent deferred tax liabilities, net	(13,480)	(40,249)
Net deferred taxes	($13,480)	($35,639)

The provision for income taxes charged to operations was as follows:

YEAR ENDED DECEMBER 31,	1999	2000	2001
(In thousands)			
Current tax expense			
Federal	$2,759	$ 6,199	$ 5,542
State	108	660	107
Total current	2,867	6,859	5,649
Deferred tax expense (benefit)			
Federal	1,227	3,447	7,159
State	(317)	(169)	(200)
Total deferred	910	3,278	6,959
Total provision	$3,777	$10,137	$12,608

The following is a reconciliation of the statutory federal income tax rate to the actual effective income tax rate for the following periods:

YEAR ENDED DECEMBER 31,	1999	2000	2001
Percent of pretax income			
Federal tax rate	34.0%	34.0%	35.0%
State and local income taxes, net of federal tax benefit	2.0	1.1	(.2)
Permanent difference relating to amortization of goodwill	.2	.1	.3
Other miscellaneous items	(.3)	.1	(.4)
	35.9%	35.3%	34.7%

6. SUPPLEMENTAL DISCLOSURES OF CASH FLOW INFORMATION

Cash paid during the year for interest was $8.7 million, $18.4 million and $36.7 million in 1999, 2000 and 2001, respectively.

Cash paid during the year for income taxes was $3.0 million, $3.9 million and $3.5 million in 1999, 2000 and 2001, respectively.

7. STOCK BASED COMPENSATION

In April 1994, the Company's Board of Directors and shareholders adopted and approved the Stock Option Plan (the "Plan"). The Plan permits the grant of options to purchase up to 3,000,000 shares of Common Stock, subject to antidilution adjustments, at a price per share no less than 100% of the fair market value of the Common Stock on the date an option is granted with respect to incentive stock options only. The price would be no less than 110% of fair market value in the case of an incentive stock option granted to any individual who owns more than 10% of the total combined voting power of all classes of outstanding stock. The Plan provides for the granting of both incentive stock options intended to qualify under Section 422 of the Internal Revenue Code of 1986, and nonqualified stock options, which do not so qualify. At December 31, 2001, there were 758,250 options available for future grants under the Plan. Unless the Plan is terminated earlier by the Board of Directors, the Plan will terminate in April 2004.

Stock options that expire between October 23, 2002 and January 1, 2011 have been granted to officers and directors to purchase Common Stock at prices ranging from $3.33 to $27.77 per share. All options were granted at market prices at date of grant. The following table contains information on stock options issued under the Plan for the three-year period ended December 31, 2001:

	OPTION SHARES	AVERAGE EXERCISE PRICE
Outstanding at January 1, 1999	1,184,500	$ 9.50
Granted	149,500	6.98
Exercised	(27,000)	5.63
Canceled	(31,750)	13.40
Outstanding at December 31, 1999	1,275,250	7.27
Granted	294,500	9.65
Exercised	(145,000)	4.77
Canceled	(11,000)	10.36
Outstanding at December 31, 2000	1,413,750	8.01
Granted	518,000	11.70
Exercised	(474,250)	6.19
Canceled	(23,000)	4.77
Outstanding at December 31, 2001	1,434,500	10.00

In addition, 300,000 Common Stock options were issued to the Company's Chairman outside the Plan on October 23, 1996. These options were issued at $17.63 per share and are exercisable through October 23, 2006.

Exercisable at year end:

	OPTION SHARES	WEIGHTED AVERAGE EXERCISE PRICE
1999	1,242,625	$ 9.49
2000	1,228,792	10.03
2001	900,418	11.98

The following table summarizes information about stock options outstanding at December 31, 2001:

	EXERCISE PRICE RANGE			TOTAL
	$3.33 TO $6.88	$7.31 TO $10.63	$10.75 TO $27.77	$3.33 TO $27.77
Outstanding options				
Number outstanding	424,750	673,250	636,500	1,734,500
Weighted average remaining contractual life (years)	3.96	6.51	4.69	5.22
Weighted average exercise price	$5.08	$9.63	$17.25	$11.32
Exercisable options				
Number outstanding	336,959	58,459	505,000	900,418
Weighted average exercise price	$4.65	$8.14	$17.32	$11.98

In accordance with Statement of Financial Accounting Standards No. 123, "Accounting for Stock-Based Compensation" ("SFAS 123"), the Company has adopted fair value as the measurement basis for transactions in which the Company acquires goods or services from nonemployees in exchange for equity instruments. In addition, SFAS 123 also has certain disclosure provisions. Accounting Principles Board Opinion No. 25, "Accounting for Stock Issued to Employers" ("APB 25"), uses an intrinsic value based method of accounting. The Company has decided to continue to apply APB 25 for its stock-based employee compensation arrangements. Accordingly, no compensation cost has been recognized. Had compensation cost for the Company's employee stock option plan been determined based on the fair value at the grant date for awards under the plan consistent with the method of SFAS 123, the Company's net income and net income per share would have been as follows:

YEAR ENDED DECEMBER 31, *(In thousands, except per share data)*	1999	2000	2001
Net income			
As reported	$6,733	$11,992	$23,758
Pro forma	6,143	11,702	22,985
Basic net income per share			
As reported	$.45	$.80	$1.55
Pro forma	.41	.78	1.50
Diluted net income per share			
As reported	$.44	$.78	$1.49
Pro forma	.40	.76	1.44

The weighted average fair value of the stock options granted during the years ended December 31, 1999, 2000 and 2001 were $2.21 million, $3.95 million and $7.71 million, respectively. The fair value of each option grant is estimated on the date of grant using the Black-Scholes option-pricing model with the following weighted average assumptions used for grants in 1999, 2000 and 2001: dividend yield of 0%; expected volatility of 35%; risk-free interest rate of 6%; and expected lives of five years. The effects of applying SFAS 123 in the above pro forma disclosure are not indicative of future amounts. SFAS 123 does not apply to awards prior to 1995. Additional awards in future years are anticipated.

8. SHAREHOLDER RIGHTS PLAN

On May 20, 1998, the Board of Directors of the Company authorized and declared a dividend distribution of one Preferred Stock purchase right (the "Rights") for each outstanding share of the Company's common stock, par value $.01 per share (the "Common Shares"), payable to shareholders of record at the close of business on March 19, 1999. Each Right entitles the registered holder to purchase from the Company one one-hundredth of a share (a "Preferred Stock Fraction"), or a combination of securities and assets of equivalent value, at a purchase price of $40.00 per Preferred Stock Fraction (the "Purchase Price"), subject to adjustment. The description and terms of the Rights are set forth in a Rights Agreement (the "Rights Agreement") dated March 2, 1999 between the Company and Continental Stock Transfer and Trust Company as Rights Agent. All terms not otherwise defined herein are used as defined in the Rights Agreement.

The Rights will be exercisable only if a person or group acquires 15% or more of the Company's common stock (the "Stock Acquisition Date"), announces a tender or exchange offer that will result in such person or group acquiring 20% or more of the outstanding common stock or is a beneficial owner of a substantial amount of Common Shares (at least 10%) whose ownership may have a material adverse impact ("Adverse Person") on the business or prospects of the Company. The Company will be entitled to redeem the Rights at a price of $.01 per Right (payable in cash or stock) at any time until 10 days following the Stock Acquisition Date or the date on which a person has been determined to be an Adverse Person. If the Company is involved in certain transactions after the Rights become exercisable, a Holder of Rights (other than Rights owned by a shareholder who has acquired 15% or more of the Company's outstanding common stock or is determined to be an Adverse Person, which Rights become void) is entitled to buy a number of the acquiring company's Common Shares or the Company's common stock, as the case may be, having a market value of twice the exercise price of each Right. A potential dilutive effect may exist upon the exercise of the Rights. Until a Right is exercised, the holder will have no rights as a stockholder of the Company, including, without limitations, the right to vote as a stockholder or to receive dividends. The Rights are not exercisable until the Distribution Date and will expire at the close of business on March 18, 2009, unless earlier redeemed or exchanged by the Company.

9. SEGMENT INFORMATION

The Company has adopted SFAS No. 131 "Disclosures About Segments of an Enterprise and Related Information." The Company has determined that it currently operates in two segments: (1) gaming and (2) racing.

The accounting policies for each segment are the same as those described in the "Summary of Significant Accounting Policies" for the year ended December 31, 2001. The Company and the gaming industry use earnings before interest, taxes, depreciation and amortization, ("EBITDA") as a means to evaluate performance. EBITDA should not be considered as an alternative to, or more meaningful than, net income (as determined in accordance with accounting principles generally accepted in the United States) as a measure of operating results or cash flows (as determined in accordance with accounting principles generally accepted in the United States) or as a measure of the Company's limitations.

The table below presents information about reported segments (in thousands):

YEAR ENDED DECEMBER 31,	1999	2000	2001
(In thousands)			
REVENUES			
Gaming(1)(2)	$ 80,015	$191,495	$422,012
Racing	91,933	101,937	98,766
Eliminations(3)	(1,588)	(1,631)	(1,386)
Total	$170,360	$291,801	$519,392

YEAR ENDED DECEMBER 31,	1999	2000	2001
(In thousands)			
EBITDA(4)			
Gaming(1)(2)	$ 8,628	$38,988	$ 95,100
Racing	17,868	20,493	17,236
Total	$26,496	$59,481	$112,336

AS OF DECEMBER 31,	2000	2001
(In thousands)		
TOTAL ASSETS		
Gaming(1)(2)	$673,682	$1,092,400
Racing	91,756	90,014
Eliminations(5)	(325,538)	(503,037)
	$439,900	$ 679,377

(1) Reflects results of the Mississippi properties since August 8, 2000 acquisition.

(2) Reflects results of the CRC Acquisition since April 28, 2001.

(3) Primarily reflects intercompany transactions related to import/export simulcasting.

(4) EBITDA consists of income from operations, plus depreciation and amortization, plus earnings from joint venture.

(5) Primarily reflects elimination of intercompany investments, receivables and payables.

10. SUMMARIZED QUARTERLY DATA (UNAUDITED)

Following is a summary of the quarterly results of operations for the years ended December 31, 2000 and 2001:

	FISCAL QUARTER			
(In thousands, except per share data)	FIRST	SECOND	THIRD	FOURTH
2000				
Total revenues	$ 52,119	$ 60,911	$ 86,982	$ 91,789
Income from operations	7,627	11,208	14,446	11,839
Net income (loss)	3,622	6,227	(582)	2,725
Basic earnings (loss) per share	.24	.42	(.04)	.18
Diluted earnings (loss) per share	.24	.40	(.04)	.18
2001				
Total revenues	$105,160	$132,732	$145,534	$135,966
Income from operations	14,778	21,236	23,298	18,400
Net income	4,619	6,485	7,710	4,944
Basic earnings per share	.31	.42	.50	.32
Diluted earnings per share	.30	.40	.48	.31

11. PENDING ACQUISITION

On August 30, 2001, the Company entered into a definitive agreement to acquire all of the assets of the Bullwhackers Casino operations, in Black Hawk, Colorado, from Colorado Gaming and Entertainment Co., a subsidiary of Hilton Group plc, for $6.5 million in cash. The Bullwhackers assets consist of the Bullwhackers Casino, the adjoining Bullpen Sports Casino, the Silver Hawk Saloon and Casino, an administrative building and a 475-car parking area, all located in the Black Hawk, Colorado gaming jurisdiction.

The Bullwhackers properties comprise a total of 63,800 square feet of interior space, 20,700 square feet of which is devoted to gaming, consisting of 1,002 slot machines and 16 table games. The properties are located on leased land as well as 3.25 acres of land included in the acquisition, much of which is utilized for parking. The transaction is anticipated to close in the second quarter of 2002. As of December 31, 2001, the Company has advanced $0.5 million under the terms of the agreement.

12. SUBSEQUENT EVENTS

On February 20, 2002 the Company closed an offering of 4,600,000 shares of common stock in a public offering. The price of the public offering was $30.50 per share. Of the common shares sold in the offering, 3,350,000 shares were sold by the Company and 1,250,000 shares were sold by The Carlino Family Trust, a related party. The Company intends to use its net proceeds from the offering of approximately $96.0 million, after deducting underwriting discounts and related expenses, to repay indebtedness under the existing senior secured credit facility. The Company did not receive any proceeds from the offering by The Carlino Family Trust.

On February 28, 2002, the Company consummated an offering of up to $175.0 million aggregate principal of 8⅞% Senior Subordinated Notes due March 15, 2010. The net proceeds of these notes will be used to repay outstanding loan indebtedness under the Company's senior credit facility. The Senior Subordinated Notes will rank equally with all of the Company's other existing and future senior subordinated indebtedness and will be junior to the Company's senior indebtedness, including debt under the Company's secured credit facility.

On February 13, 2002, Showboat Development Company filed a lawsuit against the Company in the United States District Court for the Eastern District of Pennsylvania. The substance of this lawsuit is similar to the claim that was dismissed in Nevada.

On March 28, 2002, Penn National and Showboat agreed to settle all litigation related to this matter. Under the settlement, the Company agreed to make a one-time payment of $1.0 million to Showboat, which was recognized in general and administrative expenses in our operating results for the fourth quarter of 2001. (See Note 4 – Commitments and Contingencies.)

REPORT OF INDEPENDENT CERTIFIED PUBLIC ACCOUNTANTS

PENN NATIONAL GAMING, INC. AND SUBSIDIARIES
WYOMISSING, PENNSYLVANIA

We have audited the accompanying consolidated balance sheets of Penn National Gaming, Inc. and subsidiaries as of December 31, 2000 and 2001, and the related consolidated statements of income, shareholders' equity, and cash flows for each of the three years in the period ended December 31, 2001. These consolidated financial statements are the responsibility of the Company's management. Our responsibility is to express an opinion on these consolidated financial statements based on our audits.

We conducted our audits in accordance with auditing standards generally accepted in the United States of America. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the consolidated financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the consolidated financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall consolidated financial statement presentation. We believe that our audits provide a reasonable basis for our opinion.

In our opinion, the consolidated financial statements referred to above present fairly, in all material respects, the financial position of Penn National Gaming, Inc. and subsidiaries at December 31, 2000 and 2001, and the results of their operations and their cash flows for each of the three years in the period ended December 31, 2001 in conformity with accounting principles generally accepted in the United States of America.

BDO Seidman, LLP

BDO Seidman, LLP
Philadelphia, Pennsylvania
January 25, 2002, except for Note 12, which is as of March 28, 2002.

OFFICERS AND DIRECTORS

PETER M. CARLINO
Chairman of the Board and Chief Executive Officer

KEVIN DeSANCTIS
President and Chief Operating Officer (1)

ROBERT S. IPPOLITO
Vice President, Secretary and Treasurer

WILLIAM J. CLIFFORD
Senior Vice President, Finance, and Chief Financial Officer (1)

RICHARD ORBANN
President of Racing Operations

HAROLD CRAMER, ESQ.
Director, Retired Partner of Schnader Harrison Segal & Lewis LLP

DAVID A. HANDLER
Director, Senior Managing Director, Bear, Stearns & Co., Inc.

ROBERT P. LEVY
Director, Chairman of the Board, Atlantic City Racing Association

WILLIAM J. BORK
Director, Retired President, Penn National Gaming, Inc.

JOHN M. JACQUEMIN
Director, President, Mooring Financial Corporation

BDO SEIDMAN, LLP
Independent Certified Public Accountants
1700 Market Street, Philadelphia, Pennsylvania 19103

SCHNADER HARRISON SEGAL & LEWIS LLP
Legal Counsel
1600 Market Street, Philadelphia, Pennsylvania 19103

TRANSFER AGENT AND REGISTRAR
Continental Stock Transfer & Trust Company
17 Battery Place, New York, New York 10004

FORM 10-K
The annual report to the Securities and Exchange Commission may be obtained free of charge upon written request at its corporate offices.

MARKET INFORMATION
The Common Stock of the Company is listed on the NASDAQ National Market under the symbol PENN.

(1) Subject to the receipt of necessary licensing and regulatory approval in certain jurisdictions, Messrs. DeSanctis and Clifford will become executive officers.